Supreme Court, U. S.
FILED
JUL 19 1980
MICHAEL RODAK, JR., CLERK

No. 80-84

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

ANDERSON BROS. FORD and
FORD MOTOR CREDIT COMPANY,

Petitioners,

vs.

OLGA VALENCIA and
MIGUEL GONZALEZ,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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July 21, 1980

La Salle Street Press — Chicago Printed in U.S.A.

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QUESTIONS PRESENTED

1. Under the Truth in Lending Act and Regulation Z thereunder, is an assignment of returned or unearned insurance premiums a "security interest" requiring disclosure on the face of an automobile retail installment sales contract?

2. As all decided case law and industry-wide commercial usage at the time of execution of the contract form *sub judice* supported *not* disclosing the assignment of returned or unearned insurance premiums as a "security interest", should any ruling to the contrary be made prospective only?

3. In a Truth in Lending action, is a creditor's counterclaim for the underlying debt compulsory under Rule 13(a)?

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Petitioners, ANDERSON BROS. FORD ("Anderson Bros.") and FORD MOTOR CREDIT COMPANY ("Ford Credit"), pray that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Seventh Circuit entered in this cause on March 20, 1980. That decision squarely presents three important issues, on two of which the Circuit Courts of Appeal are now split.

OPINIONS BELOW

The opinion of the Court of Appeals (A. 1-27) is reported at 617 F.2d 1278. The opinions of the District Court (A. 29-44) are not reported.

JURISDICTION

The Judgment of the United States Court of Appeals for the Seventh Circuit was entered on March 20, 1980. The order denying Defendants' timely Petition for Rehearing was entered on April 22, 1980 (A. 47). This petition was filed within 90 days of that date.

The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

STATUTES INVOLVED

The statute and regulations involved in this case are:

Consumer Credit Protection Act, § 128(a)(10) (15 U.S.C.A. § 1638(a)(10)):

> **Sales not under open end credit plans.**
>
> (a) In connection with each consumer credit sale not under an open end credit plan, the creditor shall disclose each of the following items which is applicable:
>
> • • •

(10) A description of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit, and a clear identification of the property to which the security interest relates.

Regulation Z, 12 C.F.R. § 226.2(gg) (1980):

"Security interest" and "security" mean any interest in property which secures payment or performance of an obligation. The terms include, but are not limited to, security interests under the Uniform Commercial Code, real property mortgages, deeds of trust, and other consensual or confessed liens whether or not recorded, mechanic's, materialmen's, artisan's, and other similar liens, vendor's liens in both real and personal property, the interest of a seller in a contract for the sale of real property, any lien on property arising by operation of law, and any interest in a lease when used to secure payment or performance of an obligation.

Regulation Z, 12 C.F.R. § 226.8(b)(5) (1980):

(b) *Disclosures in sale and nonsale credit.* In any transaction subject to this section, the following items, as applicable, shall be disclosed:

* * *

(5) A description or identification of the type of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit, and a clear identification of the property to which the security interest relates or, if such property is not identifiable, an explanation of the manner in which the creditor retains or may acquire a security interest in such property which the creditor is unable to identify. In any such case where a clear identification of such property cannot properly be made on the disclosure statement due to the length of such identification, the note, other instrument evidencing the obligation, or separate disclosure statement shall contain reference to a separate pledge agreement, or a financing statement, mortgage, deed of trust, or similar document evidencing the security interest, a copy of which shall be

> furnished to the customer by the creditor as promptly as practicable. If after-acquired property will be subject to the security interest, or if other or future indebtedness is or may be secured by any such property, this fact shall be clearly set forth in conjunction with the description or identification of the type of security interest held, retained or acquired.

STATEMENT OF FACTS

On September 30, 1977, plaintiffs Olga Valencia and Miguel Gonzalez purchased a used 1974 Ford Pinto from Anderson Bros. pursuant to an Illinois Automobile Retail Installment Contract (the "Contract"), a full-sized copy of which is attached at the end of this petition. The Contract was subsequently assigned for value by Anderson Bros. to Ford Credit. Under the Contract, the plaintiffs were obligated to make 24 monthly payments of $69.16. The plaintiffs never made any of the installment payments under the Contract.

As required by the Truth in Lending Act (the "Act"), 15 U.S.C. § 1601 *et seq.*, the face of the Contract (which is the "disclosure statement" under the Act) contained certain disclosures. In paragraph 12, the Contract disclosed the security interest acquired by Ford Credit as follows:

> Security Interest: Seller shall have a security interest under the Uniform Commercial Code in the Property (described above) and in the proceeds thereof to secure the payment in cash of the Total of Payments and all other amounts due or to become due hereunder.

In paragraph 17, which is contained on the reverse side of the Contract, the Contract requires the buyer to purchase and maintain in force physical damage insurance on the vehicle. That paragraph also provided:

> *Buyer hereby assigns to Seller any monies payable under such [physical damage] insurance, by whomever*

> *obtained, including returned or unearned premiums,* and Seller hereby is authorized on behalf of both Buyer and Seller to receive or collect same, to endorse checks or drafts in payment thereof, to cancel such insurance or to release or settle any claim with respect thereto. The proceeds from such insurance, by whomever obtained, shall be applied toward replacement of the Property or payment of the indebtedness hereunder in the sole discretion of Seller. (Emphasis added.)

Under the assignment provision in the Contract italicized above, if the physical damage insurance policy on the vehicle is cancelled, any unearned premiums will be used to provide replacement insurance coverage or applied to the debt. The purpose of an assignment of unearned premiums in physical damage insurance is to assure the continued existence of the insurance on the vehicle during the life of the loan. Without the protection of such an assignment, debtors could cancel such insurance on financed vehicles in order to obtain the return of unearned insurance premiums, thereby exposing lenders to the risk of uninsured collateral.

On May 3, 1978, the plaintiffs filed a two-count Complaint against Anderson Bros. and Ford Credit. The Complaint alleged that Anderson Bros. and Ford Credit violated the Truth in Lending Act and the Illinois Motor Vehicle Retail Installment Sales Act because the Contract allegedly failed, *inter alia,* to disclose a security interest in returned or unearned physical damage insurance premiums (hereafter "unearned insurance premiums").

By an opinion issued on October 31, 1978, the District Court dismissed the Complaint in this action in its entirety for failing to state any claim for which relief could be granted (A. 29-38). With respect to the assignment of unearned insurance premiums, the District Court reasoned:

> The assignment of unearned insurance premiums is not a security interest in the normal meaning of that

> term. Although provisions of the contract cannot control the meaning of statutory language or regulations, defendant is entitled to a usual and customary application of the words used in the contract between the parties as well as those in the official documents. (A. 31).

Referring to a provision of the Illinois Motor Vehicle Retail Installment Sales Act, the District Court noted:

> [I]t helps us construe the contract in the light of Illinois law, where it is to be performed, and makes it rather clear that unearned insurance premiums do not constitute a security interest in the automobile. (A. 32).

On November 17, 1978, the District Court issued a Supplemental Decision (A. 39-41) reinstating that portion of the Complaint which alleged that the assignment of unearned insurance premiums is a "security interest." The District Court based this reversal of its initial ruling on the decision in *Edmondson* v. *Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979) (Mr. Justice White voting in favor of granting the writ).* Thereafter, on June 15, 1979 (A. 45-46), based upon a decision it rendered on June 5, 1979 (A. 42-44), the District Court entered summary judgment for plaintiffs holding that the assignment of unearned insurance premiums is a "security interest" that must be disclosed under the Truth in Lending Act and Regulation Z.

Shortly after the plaintiffs filed the Complaint, Ford Credit filed a Counterclaim against the plaintiffs. The Counterclaim alleged that the plaintiffs failed to make any payments due under the Contract and sought to recover the outstanding contract balance (less certain rebates).

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* There was no conflict between Circuits on this issue at the time this Court denied the petition for certiorari in *Edmondson*. As discussed *infra*, there is such a conflict now.

In its Opinion issued October 31, 1978, the District Court dismissed the Counterclaim when dismissing the Complaint in its entirety (A. 36-37). In its Supplemental Decision of November 17, 1978, the District Court reinstated the Counterclaim (A. 40). The District Court again dismissed the Counterclaim in the Judgment entered June 15, 1979, without explanation. (A. 45).

On March 20, 1980, the United States Court of Appeals for the Seventh Circuit rendered the opinion (A. 1-25) now sought to be reviewed affirming the District Court's decision of June 15, 1979. Judge Sprecher's opinion was accompanied by two expressly "reluctant" concurring opinions by Judges Cudahy and Swygert (A. 26-27) which noted in pertinent part that:

—the assignment provision at issue was "entirely incidental to the principal consumer credit transaction";

—requiring such provision to be disclosed as a "security interest" on the face of the contract could not be taken as seriously suggesting a furtherance of the underlying purposes of the Truth in Lending Act;

—the opinion requires "the prominent disclosure of a rather esoteric right" which if disclosed as a "security interest" merely "add[s] virtually inconsequential information—lengthening, complicating and trivializing the disclosure for no apparent benefit"; and

—"the important ends of credit disclosure . . . [might] be obscured in a whirl of litigious gamesmanship" following the opinion.

REASONS FOR GRANTING THE WRIT

There are now extant millions of installment contracts identical to the contract here at issue. They involve billions of dollars of debt and potentially enormous aggregate penalties under the Act. In the Tenth Circuit these contracts

are perfectly lawful, but in the Seventh, Fifth and Third Circuits they are held to violate the Truth in Lending Act under a most technical reading.*

The conflict among Circuits is irreconcilable. The Ford Credit contract which was the subject of the Tenth Circuit's decision in *James* is identical in all material respects to the Ford Credit form contract at issue in the opinion below and in *Edmondson*, and the Tenth Circuit expressly rejected the result reached by the Third, Fifth and Seventh Circuits. Petitioners contend that only the Tenth Circuit has correctly followed this Court's reasoning in *Ford Motor Credit Co.* v. *Milhollin*, __ U.S. __, 100 S.Ct. 790 (1980), and the legislative history of the Truth in Lending Act.

Even if the Seventh Circuit's view were accepted, any such decision should have been made prospective only. The form of security interest disclosure fully complied with prevailing judicial precedents at the time the Contract was executed. This was the credit industry's form of contract. No federal purpose will be served by permitting retroactive application of the decision below, but grossly inequitable consequences are clearly threatened by such an application.

The opinion below involves yet another conflict among Circuits which is ripe for resolution by this Court, which the Seventh Circuit noted: a conflict between the Fourth and Fifth Circuits on the issue of whether a creditor's counterclaim for the underlying debt in an action brought under the Act is a compulsory counterclaim under F. R. Civ. P. 13(a) which must be decided in the same federal

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* *Compare James* v. *Ford Motor Credit Co.*, No. 78-1806 (10th Cir. June 24, 1980) (A. 48-58) (disclosure not required), *with* the opinion below; *Edmondson* v. *Allen-Russell Ford, Inc.*, *supra;* and *Gennuso* v. *Commercial Bank & Trust Co.*, 566 F.2d 437 (3d Cir. 1977) (disclosure required).

action that resolves the debtor's Truth in Lending claim.* The opinion below rejected the analysis used by the Fifth Circuit and affirmed the District Court's dismissal of the counterclaim, thereby barring debt collection counterclaims from all Truth in Lending actions in the Seventh Circuit.

Only this Court can resolve these conflicts among the Circuits and settle these issues of tremendous importance to the nation's credit industry.

I. THE DECISION BELOW IS IN DIRECT CONFLICT WITH THE TENTH CIRCUIT'S DECISION IN *JAMES v. FORD MOTOR CREDIT CO.*

The decision below was the second of the three decisions by different Circuit Courts of Appeal which considered the same legal issue in connection with identical contract forms prepared by Ford Credit. The decision below and the Fifth Circuit's earlier decision in *Edmondson* held that Ford Credit's form contract violated the Act by not disclosing on the face of the contract the assignment of unearned insurance premiums contained on the contract's reverse side. In contrast, the Tenth Circuit's June 24, 1980 decision in *James* (A. 48-58) held that such disclosure was not required under the Act.

A. The Tenth Circuit, Unlike the Court Below, Correctly Decided this Issue by Ascertaining Congressional Intent.

The Act requires the disclosure of "[a] description of any security interest held or to be retained or acquired by

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* *Compare Plant* v. *Blazer Financial Services, Inc.*, 598 F.2d 1357 (5th Cir.), *reh. denied*, 605 F.2d 555 (5th Cir. 1979) (counterclaim is compulsory), *with Whigham* v. *Beneficial Finance Co.*, 599 F.2d 1322 (4th Cir. 1979) (counterclaim not compulsory).

the creditor in connection with the extension of credit, and a clear identification of the property to which the security interest relates." 15 U.S.C. § 1638(a)(10). The Act does not define the term "security interest." Regulation Z, 12 C.F.R. § 226.2(gg), provides that "security interest" means "any interest in property which secures payment or performance of an obligation." The Regulation does not state whether the assignment provision at issue here constitutes such an interest.*

The Tenth Circuit in *James* properly focused its analysis on whether disclosure of such assignment provision would be in accord with the purpose of the Act, which is to "assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit. . . ." 15 U.S.C. § 1601. Both the courts and Congress have recognized that placing too much detail in disclosure statements can defeat the purpose of the Act because the disclosure statements become unreadable.

The Tenth Circuit quoted with approval (A. 53) from *Milhollin, supra,* 100 S.Ct. at 798, as follows:

> The concept of "meaningful disclosure" that animates TILA (citation omitted) cannot be applied in the abstract. *Meaningful* disclosure does not mean *more* disclosure. Rather, it describes a balance between "com-

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* The following *caveat* from this Court's recent *Milhollin* decision, 100 S.Ct. at 797, is applicable here:

> [L]egislative silence is not always the result of a lack of prescience; it may instead betoken permission or, perhaps, considered abstention from regulation. In that event, judges are not accredited to supersede Congress or the appropriate agency by embellishing upon the regulatory scheme. Accordingly, caution must temper judicial creativity in the face of legislative or regulatory silence.

> peting considerations of complete disclosure . . . and the need to avoid . . . 'informational overload.' "

The Tenth Circuit then analyzed the legislative history of the 1980 amendments to the Act (discussed *infra*) and concluded that "the Act does not require, and Congress did not intend it to require, an exemplification of that interest [in unearned insurance premiums]on the face of the installment contract." (A. 54).

The opinion below reached the opposite conclusion without any discussion of whether its holding would further the purposes of the Act. In fact, such holding is likely to frustrate those purposes. Requiring the lengthy assignment provision in paragraph 17 on the back of the Contract to be added to the straightforward language in paragraph 12 on the front of the Contract would only distract the debtor from the important fact that the financed automobile (the *real* "security interest") and the proceeds therefrom were at risk if he failed to pay. The fact that the debtor assigned unearned insurance premiums, if any,* to the lender, to be applied by the lender either to replace the insurance or to pay down the debtor's loan obligation, is of virtually no consequence to the debtor. It does not place his property at risk, and giving it the same dignity of disclosure as a security interest can only result in confusion.

These concerns were certainly not lost on the reluctantly "concurring" members of the panel below, as Judge Cudahy wrote:

> I do not read it [Judge Sprecher's opinion]as seriously suggesting that the result we reach furthers the underlying purposes of the Truth in Lending Act. . . .

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* In the vast preponderance of cases unearned premiums are never collected by the creditor because they are earned during the life of the installment contract and the coterminous physical damage insurance policy. In the case at bar, there were no unearned insurance premiums since plaintiffs never paid any premiums.

> Here we require the prominent disclosure of a rather esoteric right to unearned premiums for physical damage insurance (protecting both the seller's and the buyer's interest in the property), which may be used to provide replacement insurance coverage or applied against the buyer's debt in the event of cancellation of the insurance. This "security interest" is normal in the circumstances but is entirely incidental to the principal consumer credit transaction. Primarily, it assures maintenance of the insurance and is not necessarily even related to default on the principal debt.
>
> To disclose this "security interest" on the *face* of the contract (which is the point here) is merely to add virtually inconsequential information—lengthening, complicating and trivializing the disclosure for no apparent benefit. (A. 26).

B. Disclosure of an Incidental Interest in Unearned Insurance Premiums is Inconsistent with Congressional Intent.

As noted above, Congress intended the Act to promote "meaningful disclosure of credit terms." However, Congress became concerned that overly technical judicial decisions were defeating that purpose by requiring too much complexity in disclosure statements. This concern was expressed in the Report of the Senate Committee on Banking, Housing and Urban Affairs, S. Rep. No. 96-73, 96th Cong., 1st Sess. 2 (1979), *reprinted in* [1980] U.S. Code Cong. & Adm. News 878, 879 (May 1980 Supp.):

> There is considerable evidence, for example, that disclosure forms given consumers are too lengthy and difficult to understand. Creditors, on the other hand, have encountered increasing difficulty in keeping current with a steady stream of administrative interpretations and amendments, as well as highly technical judicial decisions.

On March 31, 1980, the President approved the Truth in Lending Simplification and Reform Act (the "Simplification Act") as Title VI of P.L. 96-221. 94 Stat. 132, 168. Under Section 614(a)(9) of the Simplification Act, 94 Stat. 179, where the credit is secured the creditor shall disclose "a statement that a security interest has been taken in (A) the property which is purchased as part of the credit transaction, or (B) property not purchased as part of the credit transaction identified by item or type."

The legislative history makes it clear that this section was intended *not* to require the disclosure of "incidental interests" such as an assignment of unearned insurance premiums:

> When a security interest is being taken in property not purchased as part of the credit transaction, the Committee intends this provision to require a listing by item or type of the property securing the transaction, *but not a listing of related or incidental interests in the property.* For example, a loan secured by an automobile (not being purchased with the proceeds of the loan) would require a statement indicating that the loan is secured by an automobile *but would not require a listing of incidental or related rights which the creditor may have such as insurance proceeds or unearned insurance premiums,* rights arising under, or waived in accord with state law, accessions, accessories, or proceeds. (Emphasis added.)

S. Rep. No. 96-368, 96th Cong., 1st Sess. 30 (1979), *reprinted in* [1980] U.S. Code Cong. & Adm. News 834, 864 (May 1980 Supp.).

This amendment was designed to clarify Congress' intent in originally adopting the Act. As noted above, Congress was critical of the "highly technical judicial decisions" which have subverted the original purpose of the Act. Be-

cause of such decisions, creditors have felt compelled to issue lengthy disclosure statements "written in legalistic fine print," resulting in "a piece of paper which appears to be 'just another legal document' instead of the simple, concise disclosure form Congress intended." S. Rep. No. 96-73 at 3, [1980] U.S. Code Cong. & Adm. News at 879-80. After examining this legislative history, the Tenth Circuit in *James* was correct in concluding that Congress did not intend to require the disclosure of an assignment of unearned insurance premiums on the face of the installment contract. (A. 51-54).

C. The Decision Below Ignores the Federal Reserve Board's Regulations and Interpretations.

As previously noted, the Federal Reserve Board ("Board"), which interprets the Act, has defined "security interest" in Regulation Z, 12 C.F.R. § 226.2(gg) (1980), as "any interest in property which secures payment or performance of an obligation." The Regulation also gives some specific examples of what the Board had in mind:

> . . . security interests under the Uniform Commercial Code, real property mortgages, deeds of trust, and other consensual or confessed liens whether or not recorded, mechanic's, materialmen's, artisan's, and other similar liens, vendor's liens in both real and personal property, the interest of a seller in a contract for the sale of real property, any lien on property arising by operation of law, and any interest in a lease when used to secure payment or performance of an obligation.

These examples make it clear that the Regulation focuses on security interests the purpose and function of which is to secure the debt—and not on interests in property which are incidental to the consumer transaction at issue. Read with deference to the principal of *ejusdem generis*, Regulation Z halts the Act's disclosure requirement well short of the sort

of incidental interest in property at issue here. The opinion below ignored the clear import of the Regulation.

The staff of the Board has explained that the purpose behind disclosure of Truth in Lending Act security interests is to inform the debtor that he may lose certain property in order to satisfy the debt if he defaults.* The right to receive unearned insurance premiums is wholly unrelated to the consumer's default or to satisfaction of the debt. The very existence of the unearned premiums depends upon the cancellation of coverage, a decision not automatically triggered by a default in payment of the underlying debt. Moreover, from the moment of issuance of physical damage insurance which names the lender as a loss payee, the property interests in the policy are at least joint, and in fact belong more to the lender than the debtor as long as the debt remains unpaid. Disclosure of the assignment of unearned premiums as a security interest would simply not serve the purpose for which the Board has said such disclosures are required by the Act—to let the borrower know what property *belonging to him* will be reachable on default.

In *Rounds* v. *Community National Bank,* 454 F.Supp. 883, 888 (S.D. Ill. 1978), Chief Judge Morgan applied such principles of construction to the regulatory scheme and concluded that it would transcend the mandate of the Act to require disclosure of an assignment of unearned premiums as a "security interest." Judge Morgan noted:

> Both the assignment of unearned premiums and the assignment of insurance proceeds do provide some benefit and protection to the lender. But neither of those provisions subject the debtor's property to any lien or any risk. Rather, the insurance provisions of the agreement are properly construed as being mutually

* Federal Reserve Board Staff Opinion No. 1066 [1974-77 Special Releases Transfer Binder] CONS. CRED. GUIDE (CCH) ¶ 31,406 (June 4, 1976).

protective of the interests of both the debtor and the creditor.

* * *

If such ephemeral interests are to be deemed to be security interests within the disclosure requirements of the Act, that determination should emanate from Congressional enactment or from a determination of the Board, not from a judicial decree.

II. THE DECISION BELOW, UNLESS GIVEN ONLY PROSPECTIVE APPLICATION, WILL CAUSE INJUSTICE AND HARDSHIP TO THE CONSUMER CREDIT INDUSTRY.

Although the dollar amount involved in this case is small, it would be misleading to ignore the staggering volume of transactions that may be subject to attack under a retroactive application of the decision below.* Ford Credit urges this Court to reverse the decision below, and thus prevent any further application of its doctrine—prospective *or* retroactive. But even if this Court agrees with the decision below, under the guidelines established by this Court in *Chevron Oil Co.* v. *Huson,* 404 U.S. 97, 106-07 (1971), only prospective relief is proper in this case since (1) the Contract complied with the judicial precedents prevailing at the time it was signed; (2) no purpose of the Act would be furthered by retroactive application of the decision; and (3) a retroactive decision would be grossly inequitable.**

The Seventh Circuit refused to give only prospective application to the decision below on the ground that the weight of authority at the time the Contract was executed did not support petitioners' interpretation of the Act. (A. 18-19).

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* There are 91 cases now pending against Ford Credit alone (including one brought as a class action) which raise the issue decided below.

** There is judicial precedent for giving only prospective application to a Truth in Lending decision. *McDaniel* v. *Fulton National Bank,* 571 F.2d 948 (5th Cir.) (*en banc*), *reh. denied,* 576 F.2d 1156 (5th Cir. 1978).

The Seventh Circuit is simply wrong in this analysis. That interpretation of the Act was shared by the entire lending industry, as is shown in the brief filed below by *amici curiae* General Motors Acceptance Corporation and the Consumer Banking Association. Moreover, an examination of the pertinent cases shows that petitioners' form of disclosure *complied* with the case law prevailing at that time.*

The issue decided below was before the Seventh Circuit for the first time. (A. 19). That decision constituted a sharp break from the first two decisions on this issue by district courts in the Seventh Circuit—Judge Morgan's decision in *Rounds* v. *Community National Bank,* 454 F.Supp. 883 (S.D. Ill. 1978), and Judge McMillen's first opinion below (A. 30-32)—which held that an assignment of unearned insurance premiums was not a "security interest" requiring disclosure under the Truth in Lending Act. These district court decisions are strong evidence that the judicial precedents available to the district courts (and the credit industry) as late as 1978 endorsed the form of disclosure made by petitioners here in 1977. When even the district courts sitting in the Seventh Circuit failed in 1978 to predict correctly how the Seventh Circuit would rule on the issue decided in its March 20, 1980 opinion, petitioners do

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* There were only three district court decisions before September 30, 1977 (when the Contract was executed) which dealt with the assignment of unearned insurance premiums under the Truth in Lending Act. In *Edmondson* v. *Allen-Russell Ford, Inc.,* No. C75-940A (N.D. Ga. 1976), *aff'd,* 577 F.2d 291 (5th Cir. 1978), *cert. denied,* 441 U.S. 951 (1979), the district court held that an assignment of unearned insurance premiums was a Truth in Lending Act security interest. However, that decision was soon overruled by *Shanks* v. *Greenbriar Dodge, Inc.,* Civ. No. C75-1154A (N.D. Ga. 1976), *rev'd,* 577 F.2d 296 (5th Cir. 1978). The third district court opinion on point, *Gennuso* v. *Commercial Bank and Trust Co.,* 425 F.Supp. 461 (W.D. Pa. 1976), *rev'd,* 566 F.2d 437 (3d Cir. 1977), held that even if an assignment of unearned insurance premiums were regarded as a security interest, it need not be specifically disclosed on the face of a credit contract. *Shanks* and *Gennuso* were reversed *after* the instant contract was executed.

not understand how that court could conclude that its decision was "clearly foreshadowed" at the time the Contract was executed in 1977. Similarly, the fact that the Circuit Courts of Appeal are split today with respect to contracts identical in all relevant respects supports petitioners' position that the law was (and is) unclear on this issue.

Nowhere in the lengthy opinion below was there any explanation of how such decision would further the purpose of assuring "a meaningful disclosure of credit terms." The opinion below did not dispute that the violation of the Act alleged here is "purely technical," but concluded that the credit industry should address its concern about the technical nature of certain requirements under the Act to Congress or to the Federal Reserve Board, not to the courts. (A. 13).

The credit industry has pursued with mixed results the avenues suggested in the opinion below. The Federal Reserve Board has expressly refused to issue an *official* interpretation on this issue.* However, by adopting the Simplification Act, Congress has acted to "eliminate litigation based on purely technical violations of the Act." S. Rep. No. 96-73 at 17, [1980] U.S. Code Cong. & Adm. News at 892. But the Simplification Act will not become effective for two years. 94 Stat. 185. Therefore, until the effective date of the Simplification Act, only this Court's hand, guided by the *Chevron* standard, can avoid the unfairly harsh re-

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* Under § 1640(f) of the Act, creditors can rely on an official Board interpretation as a complete defense in drafting their contract forms. *Ford Motor Credit Co.* v. *Milhollin, supra,* 100 S.Ct. at 797. Instead, the staff of the Board, in an unofficial opinion, has instructed lenders to look to state commercial law for the answer. FRB Staff Opinion No. 1263 [1974-77 Sp. Rel. Trans. Binder] CONS. CREDIT GUIDE (CCH) ¶ 31,736 (1977). The District Court's first opinion below found that the assignment provision did *not* create a security interest under Illinois law (A. 30-32), a finding which has not been disturbed. *See also Rounds* v. *Community National Bank, supra.*

sult which would occur if the decision below—involving a purely technical and highly debatable claim under the Truth in Lending Act—were applied retroactively. Prospective application in this case would be in accord with the intent of both the legislative and executive branches of the Government as expressed in the Simplification Act.

III. THE DECISION BELOW THAT FORD CREDIT'S COUNTERCLAIM WAS NOT COMPULSORY IS IN DIRECT CONFLICT WITH A FIFTH CIRCUIT DECISION.

Under F.R. Civ. P. 13(a), a counterclaim is compulsory if it "arises out of the transaction or occurrence that is the subject matter of the opposing party's claim." The words "transaction or occurrence" should be given a liberal interpretation in order to carry out the goal of judicial economy which is embodied in Rule 13(a). 6 Wright and Miller, *Federal Practice and Procedure,* § 1410, at 40 (1971). It is undisputed that in this case both plaintiffs' Truth in Lending claim and Ford Credit's Counterclaim arose out of exactly the same transaction—the loan evidenced by the Contract.

As noted by this Court, the compulsory counterclaim rule "was designed to prevent multiplicity of actions and to achieve resolution in a single lawsuit of all disputes arising out of common matters." *Southern Construction Co.* v. *Pickard,* 371 U.S. 57, 60 (1962). This goal will be frustrated if a creditor is required to assert its debt collection claim in state court even though the debtor has already filed a Truth in Lending action involving the same transaction in federal court. It makes little sense to burden the judicial system by adopting a policy that requires two lawsuits to resolve a dispute that could be settled in one.

The Fifth Circuit recently held in *Plant v. Blazer Financial Services, Inc.,* 598 F.2d 1357 (5th Cir.), *reh. denied,* 605 F.2d 555 (5th Cir. 1979), that a creditor's counterclaim for the underlying debt in a Truth in Lending action is com-

pulsory under Rule 13(a). The Fifth Circuit reasoned that a straightforward application of Rule 13(a) to such counterclaim "clearly suggests its compulsory character because a single aggregate of operative facts, the loan transaction, gave rise to both plaintiff's and defendant's claim." 598 F.2d at 1361. The Seventh Circuit's decision below expressly refused to follow the Fifth Circuit's analysis and held that Ford Credit's Counterclaim was not compulsory and should be dismissed. (A. 21-25).

The question of whether a counterclaim for the underlying debt is compulsory has great importance for Ford Credit and the entire credit industry. If such a counterclaim is compulsory, it falls within the ancillary jurisdiction of the federal courts.* On the other hand, under the Seventh Circuit's holding below, Ford Credit is required to bring a separate action on its debt claim in state court. Ford Credit will thus have to satisfy the judgment entered in favor of plaintiffs on their Truth in Lending claim (assuming *arguendo* that such judgment is not disturbed) before it can obtain a state court judgment in its favor in the amount of the unpaid loan. Ford Credit probably will be unable to collect anything from plaintiffs—even from the funds which it paid to them. This fundamental unfairness was recognized by the Fifth Circuit:

> Absent the opportunity to bring a counterclaim, [the creditor] could be forced to satisfy the debtor's truth-in-lending claim without any assurance that his claims against the defaulting debtor arising from the same transaction will be taken into account or even that the

* 6 Wright and Miller, *Federal Practice and Procedure* § 1414, at 69 (1971). Moreover, once ancillary jurisdiction over a compulsory counterclaim has attached, the court will retain jurisdiction to decide the counterclaim even when the plaintiff's claim is disposed of before trial. *Moore* v. *New York Cotton Exchange*, 270 U.S. 593 (1926).

> funds he has been required to pay will still be available should he obtain a state court judgment. . . .
>
> To permit the debtor to recover from the creditor without taking the original loan into account would be a serious departure from the evenhanded treatment afforded both parties under the Act.

Plant v. *Blazer Financial Services, Inc., supra,* 598 F.2d at 1364. In contrast, if both claims are litigated in the same proceeding, then offsetting judgments could be applied against each other. The same "evenhanded treatment" accorded to creditors in Truth in Lending actions in the Fifth Circuit should be made available to creditors in the Seventh Circuit.

CONCLUSION

For all of the reasons stated above, we urge the Court to grant a Writ of Certiorari to review the opinion in this case so that the Court may resolve the conflicts among the Circuits presented herein and introduce some certainty into an area of the law which has a profound impact on the nation's credit economy.

Respectfully submitted,

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July 21, 1980

OPINION BELOW OF THE COURT OF APPEALS

In the

United States Court of Appeals

For the Seventh Circuit

No. 79-1950

OLGA VALENCIA and MIGUEL GONZALEZ,

Plaintiffs-Appellees,

v.

ANDERSON BROS. FORD and FORD MOTOR CREDIT COMPANY,

Defendants-Appellants.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.
No. 78 C 1718—**Thomas R. McMillen**, *Judge*.

ARGUED JANUARY 11, 1980—DECIDED MARCH 20, 1980

Before SWYGERT, SPRECHER and CUDAHY, *Circuit Judges*.

SPRECHER, *Circuit Judge*. Defendants, Anderson Brothers Ford and Ford Motor Credit Company (Ford), appeal from the district court's order finding them in violation of the Truth in Lending Act (TILA), 15 U.S.C. § 1601 *et seq.* and Regulation Z, 12 C.F.R. § 226.1 *et seq.*, and dismissing their counterclaim. This appeal presents three issues for our consideration. First, did defendants' failure to disclose an assignment of returned or unearned physical damage insurance premiums as a security interest violate the Act and Regulation Z. Second, if this court finds such a violation, should its ruling be given only prospective effect under the

doctrine of *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971). Finally, did the district court properly dismiss without prejudice defendants' counterclaim for the balance of the debt allegedly owed by plaintiffs under the installment contract at issue in this case.

I

On September 30, 1977, in connection with the purchase of a used 1974 Ford Pinto from Anderson Brothers Ford, the plaintiffs signed an Illinois Automobile Retail Installment Contract. This contract was subsequently assigned for value to Ford Motor Credit Company. The contract revealed that the plaintiffs were borrowing a sum of $1340.00, over a twenty-four month period, at an annual rate of interest of 21.40%. Record on Appeal, Document No. 14, Appendix A.

The contract contains on its face the following disclosure with respect to retention of security interests by the creditor:

> Security Interest: Seller shall have a security interest under the Uniform Commercial Code in the Property (described above) and in the proceeds thereof to secure the payment in cash of the Total of Payments and all other amounts due or to become due hereunder.

Record on Appeal, Document No. 14, Appendix A. The reverse side of the contract contains a provision requiring the debtor to purchase and maintain physical damage insurance on the auto. While this insurance apparently may be purchased through the creditor and financed under the contract, the buyer is free to obtain such insurance elsewhere as well. Regardless of the source of the insurance, the contract provides that the debtor assigns to the creditor any returned or unearned premiums payable under the insurance policy. Such premiums may be used to purchase replacement insurance coverage or may be applied to the debt in the discretion of the creditor. Brief of Appellants at 9. In addition, the creditor is given authority to cancel the

insurance policy and release or settle any claim with respect thereto.[1]

Plaintiffs contracted to purchase the required insurance through Ambassador Insurance Company at an annual premium of $442.00. Because the auto was permanently returned to Anderson Brothers due to mechanical problems on October 17, 1977, no payments were made by plaintiffs on either the insurance policy or

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[1] The contract provides, in pertinent part:

> RISK OF LOSS—INSURANCE
> The Property shall be at Buyer's risk. Buyer shall obtain and maintain at his own expense for so long as any amount remains unpaid hereunder insurance protecting the interests of Buyer and Seller against loss, damage or destruction of or to the Property in such forms and amounts as Seller may require.
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> * * *
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> If Buyer fails to obtain or maintain such insurance, or fails to furnish satisfactory evidence thereof upon request, Seller may, but shall not be required to, and without prejudice to his rights hereunder if he does not, obtain such insurance protecting either the interests of Buyer and Seller or the interests of Seller only. In such event, Buyer agrees to reimburse Seller for the cost thereof forthwith upon demand together with interest thereon at the highest lawful contract rate.
>
> Buyer hereby assigns to Seller any monies payable under such insurance, by whomever obtained, including returned or unearned premiums, and Seller hereby is authorized on behalf of both Buyer and Seller to receive or collect same, to endorse checks or drafts in payment thereof, to cancel such insurance or to release or settle any claim with respect thereto. The proceeds from such insurance, by whomever obtained, shall be applied toward replacement of the Property or payment of the indebtedness hereunder in the sole discretion of Seller.

Record on Appeal, Document No. 14, Appendix A. The contract goes on to provide that a failure to maintain the required insurance constitutes a default giving rise to the creditor's rights of acceleration and repossession. *Id.*, ¶ 18.

the installment contract.[2] The policy was eventually cancelled for nonpayment of premiums.

On May 3, 1978, plaintiffs filed suit in the court below against Anderson Brothers and Ford, alleging various violations of the Truth in Lending Act, Regulation Z and the Illinois Motor Vehicle Retail Installment Sales Act, Ill.Rev.Stat. ch. 121½, § 561 *et seq.*, including defendants' failure to disclose the assignment of unearned insurance premiums as a security interest. On October 31, 1978, the district court dismissed plaintiffs' complaint for failure to state a claim on which relief could be granted. The court specifically found that an assignment of returned or unearned insurance premiums was not a security interest and thus need not have been disclosed as such on the face of the contract.

Subsequent to its October 31 decision, the district court was informed of the July 28 decision of the Fifth Circuit in *Edmondson v. Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979). On the basis of that decision, the district court reinstated that portion of plaintiffs' complaint which pertained to disclosure of the assignment of unearned insurance premiums as a security interest. The district court entered summary judgment for the plaintiffs on this claim on June 5, 1979, finding itself in agreement with *Edmondson* that an assignment of unearned insurance premiums is a security interest that must be disclosed under 15 U.S.C. § 1638(a)(10) and 12 C.F.R. § 226.8(b)(5). The court also dismissed plaintiffs' pendent state law claims. Defendants appeal from the district

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[2] In the court below, defendants argued that plaintiffs' failure to pay the required premiums somehow foreclosed any finding of a violation of the Act or Regulation Z. The district court rejected this argument, finding the payment or nonpayment of premiums irrelevant. Defendants apparently do not contest this ruling on appeal. As our recent decision in *Bulger v. Thorp Credit Inc.*, Nos. 78-2023, 78-2024 (7th Cir. Dec. 3, 1979), indicates, the fact that a debtor may have no present interest in property in which a security interest is claimed is irrelevant for purposes of the disclosure requirements of the TILA and Regulation Z. Slip op. at 3-6.

court's summary judgment order; plaintiffs do not appeal from the dismissal of their other claims.

Defendants also appeal from the district court's dismissal of their counterclaim. The counterclaim, filed shortly after plaintiffs filed the complaint, sought to recover the balance due from plaintiffs on the installment contract. The district court dismissed the counterclaim without prejudice in its judgment entered June 15, 1979. No explanation was given for the dismissal.

II

A

The federal Truth in Lending Act, 15 U.S.C. § 1601 *et seq.*, was enacted in 1968

> to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit . . . .

15 U.S.C. § 1601. The Act does not regulate consumer credit; rather, it requires disclosure of certain terms and conditions of credit before consummation of a consumer credit transaction. *Mirabal v. General Motors Acceptance Corp.*, 537 F.2d 871, 874 (7th Cir. 1976). The Act is to be liberally construed to ensure achievement of its goal of meaningful disclosure. *Johnson v. McCrackin-Sturman Ford, Inc.*, 527 F.2d 257, 262 (3d Cir. 1975).

One of the credit terms which must be disclosed under the Act is the retention or acquisition of any security interest by the creditor in a consumer credit transaction. 15 U.S.C. § 1638(a)(10).[3] The Act, however, nowhere

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[3] The statute provides, in pertinent part:

> (a) In connection with each consumer credit sale not under an open end credit plan, the creditor shall disclose each of the following items which is applicable:
>
> * * *
>
> (10) A description of any security interest held or to be retained or acquired by the creditor in connection

(Footnote continued on following page)

defines "security interest." The Federal Reserve Board, pursuant to the authority vested in it under 15 U.S.C. § 1604,[4] promulgated Regulation Z, 12 C.F.R. § 226.1 *et seq.*, which defines "security interest" as follows:

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[3] *continued*

with the extension of credit, and a clear identification of the property to which the security interest relates.

15 U.S.C. § 1638(a)(10). Regulation Z elaborates on this disclosure requirement as follows:

> (b) Disclosures in sale and nonsale credit. In any transaction subject to this section, the following items, as applicable, shall be disclosed:
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> * * *
>
> (5) A description or identification of the type of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit, and a clear identification of the propery to which the security interest relates or, if such property is not identifiable, an explanation of the manner in which the creditor retains or may acquire a security interest in such property which the creditor is unable to identify. In any such case where a clear identification of such property cannot properly be made on the disclosure statement due to the length of such identification, the note, other instrument evidencing the obligation, or separate disclosure statement shall contain reference to a separate pledge agreement, or a financing statement, mortgage, deed of trust, or similar document evidencing the security interest, a copy of which shall be furnished to the customer by the creditor as promptly as practicable. If after-acquired property will be subject to the security interest, or if other or future indebtedness is or may be secured by any such property, this fact shall be clearly set forth in conjunction with the description or identification of the type of security interest held, retained or acquired.

12 C.F.R. § 226.8(b)(5).

[4] Section 1604 provides:

> The Board shall prescribe regulations to carry out the purposes of this subchapter. These regulations may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the pur-

(Footnote continued on following page)

> "Security interest" and "security" mean any interest in property which secures payment or performance of an obligation. The terms include, but are not limited to, security interests under the Uniform Commercial Code, real property mortgages, deeds of trust, and other consensual or confessed liens whether or not recorded, mechanic's, materialmen's, artisan's, and other similar liens, vendor's liens in both real and personal property, the interest of a seller in a contract for the sale of real property, any lien or property arising by operation of law, and any interest in a lease when used to secure payment or performance of an obligation.

12 C.F.R. § 226.2(gg). The issue before this court is whether this definition encompasses a debtor's assignment to a creditor of returned or unearned physical damage insurance premiums.

This court is not the first court of appeals to address this issue. Both the Third and Fifth Circuits have held that an assignment of unearned insurance premiums is a security interest which must be disclosed under the TILA and Regulation Z. See *Edmondson v. Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979); *Shanks v. Greenbriar Dodge, Inc.*, 577 F.2d 296 (5th Cir. 1978); *Gennuso v. Commercial Bank & Trust Co.*, 566 F.2d 437 (3d Cir. 1977).[5] *Edmondson* is

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[4] *continued*

poses of this subchapter, to prevent circumvention or evasion thereof, or to facilitate compliance therewith.

15 U.S.C. § 1604.

The regulations promulgated by the Federal Reserve Board pursuant to this authority are entitled to deference by the courts and will be upheld as long as reasonably related to the purposes of the Act. *Mourning v. Family Publications Service, Inc.*, 411 U.S. 356, 369, 372 (1973).

[5] Defendants argue that *Gennuso* is not applicable in this case because it considered only the adequacy of disclosure of an assignment of unearned insurance premiums as a security interest and not whether such an assignment was a security interest at all. It is true, as defendants contend, that the *Gen-*

(Footnote continued on following page)

particularly damaging to defendants' case in that the contract at issue there does not differ in any material respect from the one now before us. Defendants do not attempt to distinguish *Edmondson*, but rather argue that it was wrongly decided and should not be followed by this court.

The heart of the *Edmondson* opinion, and the part which draws the greatest fire from defendants, is the Fifth Circuit's reliance on federal law, in the form of Regulation Z, rather than state commercial law to define a security interest for purposes of the TILA's disclosure requirements. Defendants argue that prior decisions of this court indicate that state law is to determine whether a security interest has been created requiring disclosure under the Act. See *Basham v. Finance America Corp.*, 583 F.2d 918, 924 (7th Cir. 1978), *cert. denied*, 439 U.S. 1128 (1979); *Tinsman v. Moline Beneficial Finance Co.*, 531 F.2d 815, 818 (7th Cir. 1976).[6] Close examination of *Basham* and *Tinsman*

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[5] *continued*
nuso defendant conceded the assignment was a security interest for purposes of the Act. See *Gennuso v. Commercial Bank & Trust Co.*, 425 F.Supp. 461, 467 n.11 (W.D.Pa. 1976). However, the district court in *Gennuso* did not rely solely on this concession in finding that the installment contract created a security interest in the unearned premiums; the court specifically held that a security interest had been created and relied on the concession only for extra support. 425 F.Supp. at 467 & n.11. The Third Circuit noted its specific agreement with "the district court's determination that [the contract's provisions] create a security interest in the . . . unearned premiums of the insurance policy . . . ." 566 F.2d at 440 n.2. Both courts apparently considered this threshold issue properly before them despite the concession. Viewed in this context, *Gennuso* is a relevant precedent in the action before us. The Fifth Circuit was of the same opinion in *Edmondson*. See 577 F.2d at 294-95 & n.7.

[6] Defendants also cite *Croysdale v. Franklin Savings Ass'n*, 601 F.2d 1340 (7th Cir. 1979), as support for their contention that state law must be applied under the Truth in Lending Act. Reply Brief of Appellants at 10 n.*. This court looked to state law in *Croysdale* because of the Federal Reserve Board's deference to state rules of computation for certain transac-

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reveals, however, that this court looked to state law in those cases to determine the scope or extent of security interests clearly claimed by creditors, not to determine whether an unidentified interest was indeed a security interest. This court's recent decision in *Bulger v. Thorp Credit Inc.*, Nos. 78-2023, 78-2024 (7th Cir. Dec. 3, 1979), reveals that an interest may be a security interest for purposes of disclosure under the TILA even though it is not an enforceable security interest under state commercial law. *Id.*, slip op. at 3-4.[7]

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[6] *continued*
tions. 601 F.2d at 1347. We specifically noted that Congress did not intend to incorporate conflicting and uncertain state law rules into the Act. The state rules of computation were properly consulted in that case because the substantive law of the state involved "[did] not subvert the purposes of the Act or Regulation." *Id.*

[7] Defendants suggest that *Butner v. U.S.*, 440 U.S. 48 (1979), requires this court to apply state law to determine whether a particular interest is a security interest for purposes of the TILA. In *Butner*, the Supreme Court held that state law is to determine whether a mortgagee has a security interest in certain rents and profits, for purposes of the federal Bankruptcy Act. *Id.* at 54-55. *Butner* is not applicable here for several reasons. First, an interpretation of the Bankruptcy Act sheds little light on the proper interpretation of the TILA; the two statutes differ fundamentally in nature and purpose. Second, the definitions applied for purposes of the Bankruptcy Act determine the enforceability of creditors' rights; under the TILA, definitions control only disclosure, not enforceability of substantive interests. Indeed, a principal concern in *Butner* was that a federal definition conferred property rights not conferred by state law, *id.* at 56; in the TILA context, state law continues to govern the substantive aspects of property interests, while federal law merely classifies interests for disclosure purposes. There is thus no federal encroachment upon areas traditionally governed by state law. Finally, even under the *Butner* rule, state law is to govern "[u]nless some federal interest requires a different result." *Id.* at 55. The federal interest in uniform disclosure of credit terms requires a uniform federal definition of the terms to be disclosed. See, e.g., *Mason v. General Finance Corp.*, 542 F.2d 1226, 1231, 1233 (4th Cir. 1976). Regulation Z provides such a uniform federal definition.

The Fifth Circuit's decision in *Edmondson* followed *a fortiori* from its earlier ruling in *Elzea v. National Bank of Georgia*, 570 F.2d 1248 (5th Cir. 1978). In *Elzea*, the court held that state law characterizations of interests are not determinative for purposes of the disclosure requirements of the TILA. *Id.* at 1249-50. The court analyzed the rights conferred on the creditor by the contract to determine whether they fell within the Regulation Z definition of "security interest": "any interest in property which secures payment or performance of an obligation." 12 C.F.R. § 226.2(gg). This definition provides a straightforward, two-step approach to classification of interests for disclosure purposes. In both *Elzea* and *Edmondson*, the Fifth Circuit applied this two-step approach and found that the interests involved were security interests for TILA purposes.[8]

The *Elzea* analysis, which focuses on the nature of the substantive rights conferred on a creditor rather than on state law characterizations of those rights, was recently endorsed and applied by this court in *Bulger, supra*, slip op. at 5-6. This approach to the definition of "security interest" is reasonable, straightforward in application and furthers the federal interest in uniform disclosure of terms and conditions of consumer credit transactions. See *Edmondson, supra*, 577 F.2d at 295. We will accordingly continue to follow this approach.[9]

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[8] In both *Elzea* and *Edmondson*, the Fifth Circuit referred to the creditor's interest as a valuable economic right or privilege. *Edmondson, supra*, 577 F.2d at 294; *Elzea, supra*, 570 F.2d at 1250. Defendants and amici focus upon these references as if they formed the basis for the *Elzea* and *Edmondson* decisions. Our reading of the cases, however, reveals that these references were no more than additional support for the conclusions reached by application of the Regulation Z definition. We do not read *Elzea* and *Edmondson* to hold, as amici and defendants suggest, that a valuable privilege in the hands of a creditor, without more, is a security interest for purposes of the Act.

[9] Our research discloses that every federal court to consider whether an assignment of unearned insurance premiums is a security interest for TILA purposes since *Edmondson* has ex-

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State law is not necessarily to be ignored in determining whether a creditor's interest is a security interest for TILA purposes. Indeed, the Regulation Z definition of "security interest" lists a variety of security devices recognized under state law as examples of security interests under the Act. 12 C.F.R. § 226.2(gg).

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[9] *continued*
pressed agreement with that decision. See *Arias v. Albuquerque National Bank*, No. 78-352 (D.N.M. Jan. 5, 1979); *Hernandez v. O'Neal Motors, Inc.*, Nos. 79-226, *et al.* (D.N.M. Dec. 13, 1979); *Murphy v. Ford Motor Credit Co.*, No. 78-1091C (A) (E.D.Mo. Aug. 29, 1979). The *Murphy* case does not specifically mention unearned insurance premiums; rather, it refers to "any monies payable" under the insurance policy. The court's citation of *Edmondson* as support for its conclusion, however, suggests that an assignment of unearned premiums was encompassed within the assignment of "any monies payable."

Defendants urge us to reject the three court of appeals and three district court decisions which adopt a position contrary to their own in favor of "better-reasoned case law." This "better-reasoned case law" consists of *Rounds v. Community National Bank*, 454 F.Supp. 883 (S.D.Ill. 1978) and *James v. Ford Motor Credit Co.*, No. 78-F-647 (D.Colo. Aug. 21, 1978). Neither decision persuades us to reject *Edmondson* and its progeny.

James is unconvincing because it specifically addresses only an assignment of insurance proceeds and does not refer to unearned premiums. While this may be analogous to the issue before us, it is hardly persuasive in the face of decisions which are directly on point. *Rounds*, on the other hand, does deal with an assignment of unearned premiums and finds that it is not a security interest under Illinois law and thus need not be disclosed. 454 F.Supp. at 887-88. The *Rounds* decision has been criticized for its apparent misinterpretation of *Mims v. Dixie Finance Corp.*, 426 F.Supp. 627 (N.D.Ga. 1976), a decision on which it heavily relies. See *Hernandez, supra*, slip op. at 3; *Arias, supra*, memo. op. at 8-9. Even if the *Rounds* interpretation of *Mims* were correct, reliance on *Mims*, a decision from the Fifth Circuit, is inappropriate after *Edmondson* and *Shanks*. *Rounds* nowhere mentions the specific definition of "security interest" contained in Regulation Z, 12 C.F.R. § 226.2(gg), when, in fact, that definition should be the starting point for any analysis of the question. In light of these factors, we cannot agree with defendants' contention that *Rounds* and *James* represent "better-reasoned case law."

As post-*Edmondson* decisions addressing the precise issue before us recognize, state law can indicate whether a creditor possesses an interest in property securing performance of an obligation; if such an interest is found to exist, federal law defines it as a security interest. See *Hernandez v. O'Neal Motors, Inc.*, Nos. 79-226, *et al.* (D.N.M. Dec. 13, 1979), slip op. at 4-5; *Arias v. Albuquerque National Bank*, No. 78-532 (D.N.M. Jan. 5, 1979), memo. op. at 6-8. A creditor's substantive rights are still governed by state law; federal law merely classifies those rights for disclosure purposes.

Application of the Regulation Z definition of "security interest" in this case, as in *Edmondson*, poses no special problems. It is not seriously disputed that the assignment of unearned insurance premiums confers on the creditor an interest in property. Even defendants refer to the assignment as an "incidental interest in property." Brief of Appellants at 8. Whether incidental or not, we agree with the Fifth Circuit that such an assignment is an interest in property. 577 F.2d at 294. Similarly, we agree that this property interest secures the performance or payment of an obligation. The assigned premiums may be used, in the sole discretion of the creditor, to purchase replacement insurance coverage or to pay part of the debtor's indebtedness. In either case, the assignment secures an obligation of the debtor.[10] *Id.* at

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[10] Indeed, defendants concede the assignment is intended to ensure that the insurance coverage which the debtor is obliged to obtain is maintained through the life of the installment contract. They state in their brief:

> Under the assignment provision in the Contract, if the physical damage insurance policy on the vehicle is cancelled, any unearned premiums will be used to provide replacement insurance coverage or applied to the debt.
>
> * * *
>
> The purpose of an assignment of unearned premiums in physical damage insurance is to assure the continued existence of the insurance on the vehicle during the life of the loan. Without the protection of such an assignment, debtors could cancel such insurance on financed vehicles in order to obtain the return of unearned insurance

(Footnote continued on following page)

294. The creditor has the authority to cancel the insurance and cause payment of unearned premiums to itself at any time. The contract clearly gives the creditor an interest in property which secures performance of a debtor's obligations. Such an interest is by definition a security interest for TILA purposes, 12 C.F.R. § 226.2 (gg), and as such must be disclosed. Defendants do not suggest that such disclosure was made in the contract before us.

We reach this conclusion despite the protests of defendants and amici that such an interpretation of the TILA upsets established industry practice and will cause extreme hardship for what is, at worst, a purely technical violation. While industry practice can be a useful guide in defining terms used in the TILA in the absence of a definition in the statute or Regulation Z, *Johnson v. McCrackin-Sturman Ford, Inc.*, 527 F.2d 257, 265-66 (3d Cir. 1975), reliance on industry practice is misplaced where, as in this case, a term is clearly defined in the regulation or the Act. As for the imposition of undue hardship on the industry as a result of a purely technical violation of the Act, we repeat our recent observation:

> Congress did not intend that creditors should escape liability for merely technical violations. . . . [W]hile it may be true, in some sense, as the creditors have argued, that the terminological violations here are inconsequential, the fact remains that they are violations. Any misgivings which creditors may have about the technical nature of the requirements should be addressed to Congress or to the Federal Reserve Board, not to the courts.

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[10] *continued*
premiums, thereby causing lenders to lose insurance protection on the real "security" for such loans—the financed vehicles themselves.

Brief of Appellants at 9. The contract provides that the debtor's failure to maintain this insurance is, like a failure to pay the indebtedness, a default giving rise to creditor's remedies for default. Record on Appeal, Document No. 14, Appendix A, ¶ 18.

Smith v. No. 2 Galesburg Crown Finance Corp., Nos. 78-2145, *et al.* (7th Cir. Jan. 15, 1980), slip op. at 15, *citing Gennuso v. Commercial Bank & Trust Co.*, 566 F.2d 437 (3d Cir. 1977). See also *Kessler v. Associates Financial Services Co.*, 573 F.2d 577, 578 (9th Cir. 1977).

We therefore affirm the district court's ruling that an assignment of unearned or returned insurance premiums in a consumer credit installment contract is a security interest for purposes of disclosure under the TILA. This result is consistent with the liberal interpretation to be given the Act, the majority of federal court decisions addressing the issue, and a Federal Reserve Board staff interpretation of a closely analogous issue.[11] In view of the interest in uniformity in TILA disclosures and in the absence of any persuasive argument to the contrary, we decline to break with the Third and Fifth Circuits on this issue.

B

Alternatively, defendants argue that even if an assignment of unearned insurance premiums must be disclosed as a security interest, they have an absolute defense, under section 1640(f), to liability under the TILA because they acted in good faith in conformity with published interpretations of the Federal Reserve Board. Section 1640(f) provides:

> No provision of this section or section 1611 of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Board or in conformity with any interpretation or approval by an official or employee of the Federal Reserve System duly authorized by the Board to issue such interpretations or approvals under such procedures as the Board may prescribe therefor, notwithstanding that after such act or

[11] FRB Public Position Letter No. 377 (July 22, 1970). This letter is reproduced in full in *Edmondson v. Allen-Russell Ford, Inc.*, 577 F.2d 291, 295 n.8 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979).

> omission has occurred, such rule, regulation, interpretation, or approval is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

15 U.S.C. § 1640(f). Defendants contend that the district court erred in rejecting this defense as a matter of law. They allege several specific errors to support this contention. First, the district court required that they prove actual reliance on a Federal Reserve Board regulation or interpretation, whereas section 1640(f) only requires "conformity with" such authority. Second, defendants' good faith is an issue of material fact under section 1640(f), thereby precluding summary judgment. Finally, the court, in rejecting the defense, addressed only one of the interpretations cited by defendants, ignoring defendants' conformity with other interpretations and Regulation Z itself.

We need not address defendants' first two objections,[12] because they failed in the district court and this court to make the threshold showing required under section 1640(f). To avoid summary judgment, a defendant relying on section 1640(f) may not rest on a conclusory allegation that it acted in conformity with Board interpretations. The defendant must point to specific regulations or interpretations which support its position. *Arias v. Albuquerque National Bank*, No. 78-532 (D. N.M. Jan. 5, 1979), memo. op. at 4; *Gillard v. Aetna Finance Co.*, 414 F.Supp. 737, 749 (E.D.La. 1976). Defendants have been unable to identify any such regulations or interpretations.

Defendants direct us to three sources as the foundation of their section 1640(f) defense. First, they argue that they acted in conformity with the Regulation Z

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[12] This circuit has not yet determined whether actual reliance is required under section 1640(f) or whether accidental conformity is sufficient. See *Basham v. Finance America Corp.*, 583 F.2d 918, 923 n.7 (7th Cir. 1978), *cert. denied*, 439 U.S. 1128 (1979). Other circuits have required actual reliance. See, e.g., *Ives v. W. T. Grant Co.*, 522 F.2d 749, 758 (2d Cir. 1975). At any rate, it is not at all clear that the district court required proof of actual reliance.

definition of "security interest." 12 C.F.R. § 226.2(gg). As they read this provision, it does not include mere "incidental interests" such as that involved in this case. It is clear, however, that a creditor's mistaken interpretation of Regulation Z, even if honest and reasonable, is not a defense under section 1640(f). *Kessler v. Associates Financial Services Co.*, 573 F.2d 577, 579 (9th Cir. 1977).

Defendants also cite several official Board interpretations as support for their position that state law must be consulted to determine whether a security interest has been created. See 12 C.F.R. § 226.202; Official Staff Interpretation FC-0023, Appendix to 12 C.F.R. at 606-07; Official Staff Interpretation FC-0071, Appendix to 12 C.F.R. at 642-43; Official Staff Interpretation FC-0095, Appendix to 12 C.F.R. at 657-59. None of these interpretations concern interests even remotely similar to an assignment of unearned insurance premiums. Furthermore, as discussed in the margin, the interpretations do not stand for the proposition that the definition of "security interest" for purposes of the TILA is to be governed by state commercial law.[13] Defendants cannot rely on these interpretations to support their section 1640(f) defense.

Finally, defendants refer to Federal Reserve Board Staff Opinion No. 1263, CCH Cons. Cred. Guide ¶31,736 (Nov. 23, 1977). While this interpretation might be said

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[13] Interpretation FC-0023 does not address the definition of "security interest"; rather, it concerns only the adequacy of disclosure of an interest admitted to be a security interest. Interpretation FC-0071 concerns the adequacy of disclosure of a security interest; state law is relevant not to the creation of the security interest but only to its scope. The interpretation at 12 C.F.R. § 266.202 examines state law as to the substantive effect of judgment clauses and cognovit provisions. Such provisions are then classified as security interests according to their substantive effect under state law; this is precisely the *Elzea-Edmondson* approach adopted here. Finally, FC-0095 is a complex discussion of disclosure of security interests in consumer leasing transactions which neither clearly supports nor clearly refutes defendants' position.

to support defendants' position,[14] it is insufficient for section 1640(f) purposes for two reasons. First, it is an unofficial interpretation. This court has specifically held that conformity with unofficial staff opinion letters will not satisfy section 1640(f). *Basham v. Finance America Corp.*, 583 F.2d 918, 925 (7th Cir. 1978), *cert. denied*, 439 U.S. 1128 (1979). Second, Opinion No. 1263 was issued after execution of the contract at issue here. A creditor cannot claim to have acted in conformity with an interpretation issued after the relevant transaction has been completed. *McGowan v. Credit Center of North Jackson, Inc.*, 546 F.2d 73, 77 (5th Cir. 1977). Thus, Opinion No. 1263 is of little use to the defendants in this case.

The district court properly rejected defendants' section 1640(f) defense as a matter of law. Defendants' failure to identify specific official Board interpretations or regulations which supported their position was fatal to this defense and rendered unnecessary any inquiry as to defendants' good faith or actual reliance. We accordingly affirm the district court's ruling that defendants violated the TILA and Regulation Z.

III

Defendants contend that if this court decides to affirm the district court's judgment, as it has, the ruling should be given only prospective effect except as to the plaintiffs. The circumstances under which a judicial decision will be denied full retroactive effect are defined in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971):

> First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, . . . or by deciding an issue of first impression whose resolution was not clearly

[14] One court which addressed this precise contention found that Opinion No. 1263 did not support such a position and that it was not at all inconsistent with the result in *Edmondson*. See *Hernandez v. O'Neal Motors, Inc.*, Nos. 79-226, *et al.* (D.N.M. Dec. 13, 1979), slip op. at 4-5, 7.

> foreshadowed . . . . Second, it has been stressed that "we must . . . weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation." . . . Finally, we have weighed the inequity imposed by retroactive application, for "[w]here a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity."

404 U.S. at 106-07 [citations omitted]. Because prospective-only application is the exception rather than the rule, the party seeking to invoke *Chevron Oil* bears the burden of proving that such limited application is justified. *Jimenez v. Weinberger*, 523 F.2d 689, 704 (7th Cir. 1975), *cert. denied*, 427 U.S. 912 (1976). All three of the factors listed in *Chevron Oil* must be shown to favor prospective-only application before a decision will be denied retroactive effect. *Schaefer v. First National Bank of Lincolnwood*, 509 F.2d 1287, 1294 (7th Cir. 1975), *cert. denied*, 425 U.S. 943 (1976).

The defendants have failed to bear their burden on this issue. They have convinced this court neither that our decision overrules clear past precedent nor that it resolves an issue of first impression whose resolution was not clearly foreshadowed. At the time the parties entered the transaction at issue here, only one lower court decision clearly supported defendants' position. *Shanks v. Greenbriar Dodge, Inc.*, No. C75-1154A (N.D.Ga. Dec. 16, 1976), *rev'd*, 577 F.2d 296 (5th Cir. 1978). Another decision in the same district had reached the opposite result, holding that an assignment of unearned insurance premiums was a security interest for TILA purposes. *Edmondson v. Allen-Russell Ford, Inc.*, C75-940A (N.D.Ga. Apr. 29, 1976), *aff'd*, 577 F.2d 291 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979). Similarly, the district court in *Gennuso v. Commercial Bank & Trust Co.*, 425 F.Supp. 461 (W.D.Pa. 1976), *rev'd*, 566 F.2d 437 (3d Cir. 1977), prior to the transac-

tion in this case, had ruled that such an assignment created a security interest; the court imposed no liability, however, because it found the disclosure in that case adequate. In addition, the only relevant Federal Reserve Board interpretation issued prior to this transaction, Public Position Letter No. 377 (July 22, 1970), counselled disclosure of an analogous assignment as a security interest. The decisions on which defendants place the greatest reliance, *Rounds v. Community National Bank*, 454 F.Supp. 883 (S.D.Ill. 1978) and *James v. Ford Motor Credit Co.*, No. 78-F-647 (D.Colo. Aug. 21, 1978), were both decided after the instant contract was executed and thus cannot be clear prior precedent on which defendants may have relied.

Our examination of these authorities reveals that, at the time of the execution of the contract in this case, clear precedent did not support defendants' interpretation of the TILA. In fact, the weight of authority, such as it was, favored the opposite interpretation. At the present time, the weight of authority, now quite substantial, is in accord with the result reached in this case. It likewise cannot be said that this decision resolves an issue of first impression in a manner not foreshadowed by earlier authorities. The issue, while before this court for the first time, had been considered by several federal courts prior to the instant transaction. At least one of those decisions, the district court's opinion in *Edmondson*, reached the result reached here. One other decision, by the district court in *Gennuso*, differs from our decision in this case only on the issue of adequacy of disclosure, not on whether the assignment created a security interest. The Federal Reserve Board's resolution of a closely analogous issue in Public Position Letter No. 377 suggested the same result. To say that our decision in this case resolved an issue of first impression in a manner not foreshadowed by earlier authorities is to ignore reality.[15]

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[15] Defendants cite *McDaniel v. Fulton National Bank*, 571 F.2d 948 (5th Cir. 1978) (en banc) as proof that prospective-only application of judicial decisions interpreting the TILA is

(Footnote continued on following page)

Having decided that our ruling in this case establishes no new principle of law, it is unnecessay to address the remaining prongs of the *Chevron Oil* test. *Jordan v. Weaver*, 472 F.2d 985, 996 (7th Cir. 1973), *rev'd on other grounds sub nom. Edelman v. Jordan*, 415 U.S. 651 (1974). Nonetheless, we note that defendants have failed to persuade us that retroactive application of our ruling will retard the operation of the TILA or cause undue hardship. The Act requires disclosure of security interests as defined by Regulation Z. Our ruling merely implements that requirement. It does not disturb any clear rulings or precedents on which defendants may have relied to their detriment. We can see no inequity in its retroactive application.[16] We find, therefore, that

[15] *continued*
sometimes appropriate. *McDaniel*, while it may stand for that proposition, also indicates the limited circumstances in which such application will be decreed. Prospective application was ordered in *McDaniel* because the Fifth Circuit's decision in that case overruled an earlier decision by a panel of the same court. See *Martin v. Commercial Securities Co.*, 539 F.2d 521 (5th Cir. 1976). *McDaniel* is a far cry from the present case in which defendants can point to no clear rule in this or any other circuit on which they may have relied.

[16] As plaintiffs point out, defendants are not in an ideal position to claim that retroactive application of our ruling will cause undue hardship. Ford Motor Credit was a defendant in the *Edmondson* litigation. Ford learned on July 28, 1978, when *Edmondson* was decided by the Fifth Circuit, that at least one court of appeals considered its failure to disclose an assignment of unearned insurance premiums as a security interest a violation of the TILA. Despite this decision, Ford continued to use, in other circuits, a form contract which had been held to violate the Act in the Fifth Circuit. Ford was certainly entitled to do so since *Edmondson* was not the law in other circuits. However, in doing so Ford was gambling that its view of the law would prevail over the *Edmondson* view in subsequent suits. The fact that Ford now faces the consequences of losing its conscious gamble hardly presents a case of inequitable hardship. If the relevant provisions of Ford's contract had been modified in accordance with *Edmondson* within a reasonable time after that decision, Ford would be immune from any additional liability for this violation of the Act by virtue of the Act's one year statute of limitations. 15

(Footnote continued on following page)

prospective-only application of our decision in this case under the *Chevron Oil* doctrine is inappropriate. Defendants have failed to convince this court that any of the three *Chevron Oil* factors are present in this case.

IV

Defendants' final contention is that the district court erred in dismissing Ford's counterclaim for the balance allegedly owed by plaintiffs under the installment contract. Ford argues that dismissal was improper because the counterclaim is compulsory under Fed. R. Civ. P. 13(a).[17] It is clear that a compulsory counterclaim is within the ancillary jurisdiction of a district court and thus can proceed to trial even where the plaintiff's claim is disposed of prior to trial. *Plant v. Blazer Financial Services, Inc.*, 598 F.2d 1357, 1359 (5th Cir. 1979). A permissive counterclaim, however, cannot be entertained in federal court absent an independent basis for federal jurisdiction. *Whigham v. Beneficial Finance Co.*, 599 F.2d 1322, 1323 (4th Cir. 1979). There is no independent basis for jurisdiction over Ford's counterclaim in this case, so the issue is whether the counterclaim is permissive or compulsory.

There is a conflict between the Fourth and Fifth Circuits on this issue. The Fourth Circuit, in *Whigham*,

[16] *continued*
U.S.C. § 1640(e). The *Chevron Oil* doctrine is not directed at insulation of litigants from the consequences of their conscious business decisions; rather, its purpose is to avoid the hardship which can result from retroactive application of decisions which represent sudden, unexpected shifts in the law. This is not such a case.

[17] Rule 13(a) provides, in pertinent part:

> (a) Compulsory Counterclaims. A pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleader has against any opposing party, if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim and does not require for its adjudication the presence of third parties of whom the court cannot acquire jurisdiction.
>
> * * * *

Fed. R. Civ. P. 13(a).

supra, held that while a TILA claim and a debt counterclaim may, in a technical sense, arise from the same loan transaction, the two claims bear no logical relationship to one another. A debt counterclaim "has none of the characteristics associated with a compulsory counterclaim," 599 F.2d at 1323, and thus is permissive rather than compulsory. The Fifth Circuit has taken the opposite view. In *Plant*, *supra*, the court found that the claims are obviously interrelated and derived from a common factual basis; they are, therefore, logically related. On this basis the court held that a debt counterclaim is compulsory in a debtor's TILA suit. 598 F.2d at 1363-64. Both courts acknowledged that the majority of district courts to have considered the issue have ruled that debt counterclaims are permissive. See *Plant*, *supra*, 598 F.2d at 1361; *Whigham*, *supra*, 599 F.2d at 1323-24 n.*.[18]

The Fourth and Fifth Circuits both applied the "logical relationship" test to the debt counterclaims before them. This court considers the logical relationship test crucial in determining whether a claim and counterclaim arise from the same transaction or occurrence for purposes of Rule 13(a). We have observed that whether a particular counterclaim should be considered conpulsory depends not so much on the immediacy of its connection with the plaintiff's claim as upon its logical relationship to that claim. *Warshawsky & Co. v. Arcata National Corp.*, 552 F.2d 1257, 1261-63 (7th Cir. 1977). This test is to be applied flexibly in order to further the policies of the federal rules in general and Rule 13(a) in particular. *Id.* at 1261.

In *Plant*, *supra*, the Fifth Circuit analyzed the reasoning employed by many district courts to hold debt counterclaims permissive even where a literal application of the language of Rule 13(a) would suggest the opposite result. The primary concern of these courts was that enforcement of the TILA would be impaired if debt

[18] Both *Plant* and *Whigham* list the relevant lower court opinions. See *Plant*, *supra*, 598 F.2d at 1361-64, 1363 nn.10, 11; *Whigham*, *supra*, 599 F.2d at 1323-24 n.*.

counterclaims were compulsory because TILA plaintiffs would often be faced with counterclaims exceeding their potential recovery under the Act. In addition, TILA claims could not be expeditiously resolved if courts were entangled in the state law issues raised by debt counterclaims. 598 F.2d at 1361. The Fifth Circuit found that these and other concerns were outweighed by the interests in judicial economy and in providing complete relief to a defendant in a single lawsuit. *Id.* at 1363-64.

We disagree with the Fifth Circuit's analysis. The sole connection between a TILA claim and a debt counterclaim is the initial execution of the loan document. A flexible application of the logical relationship test reveals that this connection is so insignificant that compulsory adjudication of both claims in a single lawsuit will secure few, if any, of the advantages envisioned in Rule 13(a). As one court analyzed this issue:

> The link is credit extension, a fact established on the face of the pleadings, but the federal claim and state counterclaim do not stand on common ground when realistically assessed; the critical legal inquiry into each "half" of the controversy is so distinct that the parties' disputes are actually fragmented whether pursued through two actions or as separate aspects of one. In these circumstances, wooden application of the common transaction label does not yield real judicial economy; any perceived logical nexus is conceptual, abstract, a formal characterization rather than a recognition of concrete advantage to be achieved through single forum adjudication of all the parties' opposing claims. Even if inappropriate to weigh in the balance those policy considerations against federal court intervention, . . . in examining the state law counterclaim for purposes of Rule 13 this Court need not disregard the crucial factor of practical importance that the truth in lending complaint and debt counterclaim lack any shared realm of genuine dispute.

Ball v. Connecticut Bank & Trust Co., 404 F.Supp. 1, 4 (D.Conn. 1975) [citation omitted].

The TILA claim and debt counterclaim raise different legal and factual issues governed by different bodies of law. A TILA suit for inadequate disclosure, such as the instant case, can often be resolved by an examination of the face of the loan document. A debt counterclaim, on the other hand, can raise the full range of state law contract issues.[19] The two claims do not, as the Fifth Circuit held, spring from the same "aggregate of operative facts." *Plant, supra,* 598 F.2d at 1361. The rights and obligations of the parties with respect to the two claims hinge on different facts and different legal principles. We concur in the Fourth Circuit's characterization of the relationship between the claims:

> The lender's counterclaim alleges simply that the borrower has defaulted on a private loan contract governed by state law. The borrower's federal claim involves the same loan, but it does not arise from the obligations created by the contractual transaction. [citation omitted] Instead, the claim invokes a statutory penalty designed to enforce federal policy against inadequate disclosure by lenders.

Whigham, supra, 599 F.2d at 1324. Such claims are not logically related to one another and resolution of both in a single suit will not further the purposes of Rule 13(a).

Similarly, we concur in the Fourth Circuit's observation that permitting a creditor to "use the federal proceedings as an opportunity to pursue private claims against the borrower would impede expeditious enforcement of the federal penalty . . . ." *Id.* at 1324. In the absence of a relationship between the claims which will further the purposes of Rule 13(a), we decline to employ a mechanical interpretation of that rule in a way which will impede enforcement of an important federal statute.

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[19] It is true, as the Fifth Circuit observed, that a district judge is presumed competent to resolve such state law issues. *Plant, supra,* 598 F.2d at 1363, 1364. However, the fact that these issues can be capably resolved in a single suit does not indicate that they are best resolved in a suit raising federal claims unrelated to the substance of the loan agreement or any question of performance or default.

The result reached by the Fourth Circuit is consistent with prior decisions of this court[20] and the flexible approach to Rule 13(a) mandated in this circuit. Ford's counterclaim was dismissed without prejudice, so it is free to pursue its claim in state court. Accordingly, we affirm the district court's dismissal of Ford's counterclaim.

Having considered defendants' arguments and finding all without merit, we affirm the judgment appealed from in all respects.[21]

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[20] The Fourth Circuit in *Whigham* found that this court's decision in *Basham v. Finance America Corp.*, 583 F.2d 918 (7th Cir. 1978), *cert. denied*, 439 U.S. 1128 (1979), supported its conclusion. 599 F.2d at 1323 n.*, 1324. In *Basham*, we noted, in a different context, that a "TILA claim is not directed at or an answer to the underlying debt." 583 F.2d at 928. We also acknowledged that some district courts had found TILA claims and the underlying debt "not so related as to be the subject of a compulsory counterclaim . . . ." *Id.* at 928 n.18.

It is also interesting to note that in this portion of the appeal defendants ignore *Rounds v. Community National Bank*, 454 F.Supp. 883 (S.D.Ill. 1978), on which they relied so heavily elsewhere. In *Rounds*, the court dismissed the lender's counterclaim, observing that:

> This court has consistently held that a counterclaim upon the underlying credit obligation is not a compulsory counterclaim in a TILA action.

Id. at 890.

[21] We have examined *Ford Motor Credit Co. v. Milhollin*, 48 U.S.L.W. 4145 (Feb. 20, 1980), cited by defendants pursuant to Circuit Rule 11. As defendants state,

> *Milhollin* shows the critical importance of having a formal FRB interpretation that creditors may unhesitatingly rely upon as a complete defense under Section 1640(f) of the Act, . . .

In *Milhollin*, an official interpretation issued by the Board's staff directly supported the position taken by the defendant creditors. The Supreme Court found that section 1640(f) of the Act signalled a congressional decision to treat such official interpretations, whether by the Board or its staff, as authoritative. See 48 U.S.L.W. at 4148 & n.9. This "special status" was not, however, conferred under section 1640(f) upon

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CUDAHY, *Circuit Judge*, concurring. Judge Sprecher's opinion for the panel is exemplary in its logic, learning, legal analysis and lucidity of expression. But I do not read it as seriously suggesting that the result we reach furthers the underlying purposes of the Truth in Lending Act. Among these meritorious purposes are the disclosure to buyers of the costs of credit and the alerting of customers to the possibility that their property may be reached to satisfy the obligation which they have incurred.

Here we require the prominent disclosure of a rather esoteric right to unearned premiums for physical damage insurance (protecting both the seller's and the buyer's interest in the property), which may be used to provide replacement insurance coverage or applied against the buyer's debt in the event of cancellation of the insurance. This "security interest" is normal in the circumstances but is entirely incidental to the principal consumer credit transaction. Primarily, it assures maintenance of the insurance and is not necessarily even related to default on the principal debt.

To disclose this "security interest" on the *face* of the contract (which is the point here) is merely to add virtually inconsequential information—lengthening, complicating and trivializing the disclosure for no apparent benefit.

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[21] *continued*
unofficial interpretations. See *id.* at 4148 n.10. In the present case, there is no official interpretation by the Board or its staff as to the proper treatment of an assignment of unearned insurance premiums. That such an interpretation might be desirable or even "critical" from the credit industry's viewpoint does not alter the fact that no official Board interpretation supports defendants' position in this case. The Board's failure to issue an official interpretation does not indicate that our ruling should be given only prospective effect. That decision is governed by the *Chevron Oil* criteria discussed in Part III, *supra*. Our examination of those criteria reveals that this is not an appropriate case in which to issue a prospective ruling. *Milhollin* does not require a different result.

As Senator Proxmire has said:

> "As sponsor of the original Truth in Lending Act I am becoming more and more concerned that its beneficial purposes are being frustrated by unnecessarily complex disclosure requirements which consumers may ignore or fail to understand.
>
> "In addition, the very complexity of the requirements may impose significant costs and other burdens on creditors despite their good faith efforts to comply with the law." 122 Cong. Rec. 23609 (1976).

I concur today with this Court's good faith efforts to apply (or comply with) the law, but I feel some concern about the purposes for which we are laboring. I hope that the important ends of credit disclosure will not be obscured in a whirl of litigious gamesmanship.

SWYGERT, *Circuit Judge*, concurring. Judge Sprecher's impeccable logic compels me to concur in his opinion and to approve the result we announce. I do so reluctantly, however, because of the concerns—which I share—that are expressed by Judge Cudahy in his concurrence.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

USCA 4512—Midwest Law Printing Co., Inc., Chicago—3-20-80—350

ORDER OF THE COURT OF APPEALS

MARCH 20, 1980

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Chicago, Illinois 60604

March 20, 1980

Before

Hon. LUTHER M. SWYGERT, Circuit Judge
Hon. ROBERT A. SPRECHER, Circuit Judge
Hon. RICHARD D. CUDAHY, Circuit Judge

No. 79-1950

OLGA VALENCIA AND MIGUEL GONZALEZ,
Plaintiffs-Appellees,

vs.

ANDERSON BROS. FORD AND FORD MOTOR CREDIT COMPANY,
Defendants-Appellants.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

No. 78-C-1718

Thomas R. McMillen, *Judge*

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, AFFIRMED, with costs, in accordance with the opinion of this court filed this date.

DECISION OF THE DISTRICT COURT

OCTOBER 31, 1978

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 78 C 1718

OLGA VALENCIA AND MIGUEL GONZALEZ,

Plaintiffs,

v.

ANDERSON BROTHERS FORD AND FORD MOTOR CREDIT COMPANY,

Defendants.

DECISION

Defendant Ford Motor Credit Co. filed a motion to dismiss the complaint in the above-entitled cause on June 9, 1978, subsequently supported by an affidavit of its Collections Supervisor dated June 15, 1978. The affidavit incorporates a true copy of the Automobile Retail Installment Contract upon which the complaint is based, and contains a statement of this defendant's policy and practice under paragraph 18 of the Contract, thus converting the motion to dismiss into one for summary judgment with respect to the matters contained in the affidavit. We find and conclude that no genuine issues of material fact are presented by the pleadings and that this defendant's motion to dismiss the complaint should be granted as a matter of law.

The complaint is typical of many filed pursuant to the Truth in Lending Act, 15 U.S.C. §1601 *et seq.* and Regulation Z thereunder, 12 C.F.R. ¶226 *et seq.*, adding a pendent claim pursuant to the Illinois Motor Vehicle Retail Installment Sales Act, Ch. 121½ §561 *et seq.* of the *Ill. Rev. Stat.* (1977). Plaintiffs sue for $639.68 statutory damages together with attorney's fees and costs, and also seek an

injunction restraining the collection of any finance charges, delinquency or collection charges, past, present or future, pursuant to the Illinois statute. Defendant counterclaims for the amount overdue on the contract.

We will deal with the five specific violations of the Truth in Lending Act alleged in par. 11 of the Complaint, and in doing so will dispose of the equivalent violations alleged under the Illinois statute. Defendant is alleged to have violated the Acts:

> (a) By failing to disclose a retained security interest in returned or unearned insurance premiums in violation of Regulation Z § 226.8(b)(5) and 226.8(a).

Regulation 226.8(b)(5) requires specific disclosures to include:

> A description or identification of the type of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit, . . .

The security interest complained of, according to plaintiffs' supporting memorandum, is described in § 17 contained on the reverse side of the Contract:

> RISK OF LOSS-INSURANCE
>
> • • •
>
> Buyer hereby assigns to Seller any monies payable under such insurance, by whomever obtained, including returned or unearned premiums, and Seller hereby is authorized on behalf of both Buyer and Seller to receive or collect same, to endorse checks or drafts in payment thereof, to cancel such insurance or to release or settle any claim with respect thereto. The proceeds from such insurance, by whomever obtained, shall be applied toward replacement of the Property or payment of the indebtedness hereunder in the sole discretion of Seller.

If the foregoing § 17 of the Contract constitutes a "security interest" within the meaning of Regulation 226.8(b)(5), then pursuant to Regulation 226.8(a) it is an "obligation" which must be disclosed on the face of the contract above the customer's signature or on a separate statement which identifies the transaction. The better view, in our opinion, is that the assignment of proceeds of unearned premiums in § 17 of the Contract is not a security interest when viewed in the context of the contract or in the purchase and sale of automobiles. It is not similar to a chatel mortgage. It is not a lien on the automobile which must be disclosed on the certificate of title, need not be released in order to transfer clear title to the automobile, and can be used, according to § 17, either toward replacement of the automobile or payment of the purchaser's indebtedness.

It is instructive to note that a security interest is defined in § 12 of the Contract, above the purchaser's signature, as follows:

> Seller shall have a security interest under the Uniform Commercial Code in the Property [an automobile] and in the proceeds *thereof* to secure the payment in cash of the Total of Payments and all other amounts due or to become due hereunder. [emphasis added]

This grants a security interest in the property itself and in its proceeds, in the event of a creditor's sale, and is the customary type of security interest retained on an installment contract for the purchase of an automobile. The assignment of unearned insurance premiums is not a security interest in the normal meaning of that term. Although provisions of the contract cannot control the meaning of statutory language or regulations, defendant is entitled to a usual and customary application of the words used in the contract between the parties as well as those in the official documents.

We also note a provision in § 570 of the Illinois statute, which must be read *in pari materia* with the Federal statute, as follows:

> If any required insurance for which an amount is included in the contract is cancelled, any unearned insurance refund . . . shall be credited on the final maturing installments of the contract except to the extent those amounts are applied toward payment for similar insurance protecting the interests of the buyer and the holder or either of them. . . .

In the case at bar, no insurance premiums were "included in the contract," hence the foregoing § 570 is not strictly applicable. Nevertheless, it helps us construe the contract in the light of lllinois law, where it is to be performed, and makes it rather clear that unearned insurance premiums do not constitute a security interest in the automobile. As with many other provisions, it provides an added protection to secure performance of the buyer's financial obligation under the contract, but below the level of a "security interest." See also *Shanks* v. *Greenbriar Dodge, Inc.*, Civ. No. C75-1154A (N.D. Ga. Dec. 16, 1976).

> (b) By failing to disclose a retained security interest in insurance proceeds in violation of Reg. Z, §§226.8(b)(5) and 226.8(a).

This retention is disclosed in § 12 on the face of the contract, quoted above, p. 4. For this reason, and for the reason that plaintiffs have not pointed out any reason why the assignment of insurance proceeds is any different, as a matter of law, than the assignment of unearned insurance premiums, defendant Ford is entitled to dismissal of this allegation of par. 11 of the Complaint.

> (c) By failing to properly disclose that the entire balance would become due immediately on default without demand or notice and without providing for

a partial refund of the unearned finance charge in violation of Regulation Z § 226.8(b)(6) and (7).

(d) By failing to properly disclose that the entire balance would become due immediately on default without demand or notice and without providing for a partial refund of the unearned finance charge in violation of 15 U.S.C. § 1638(a)(9) and Regulation Z § 226.8(b)(4).

In these subparagraphs, plaintiffs complain about the provisions of § 18 of the Contract, contained on the reverse side from the signature page. This section provides for acceleration, upon default, of all amounts due or to become due, and incorporates all remedies available under the Uniform Commercial Code. It does not specify how unearned finance charges will be computed and whether or not they will be credited to the buyer. In this respect, plaintiffs rely upon 15 U.S.C. § 1638(a)(9) and 12 C.F.R. § 226.8(b)(4). Both of these require disclosure of "default, delinquency, or similar charges." In addition, 12 C.F.R. § 226.8(b)(6) and (7) apply to "penalty charges" and the computation of unearned finance charges upon *voluntary* prepayment of the principal. Defendant's contract computes only the latter.

The short answer to this contention is that an acceleration clause does not constitute a "charge" if the unearned interest is not retained by the seller. The overwhelming weight of authority is contrary to the plaintiffs' contentions. *Griffith* v. *Superior Ford,* 577 F.2d 455 (8th Cir. 1978); see also *McDaniel* v. *Fulton National Bank of Atlanta,* 571 F.2d 948, 950 (5th Cir. 1978) (en banc). The *Griffith* court rejects, as we do, the rather artificial approach taken by the Ninth Circuit in *St. Germain* v. *Bank of Hawaii,* 573 F.2d 572, 576 (9th Cir. 1977), to the effect that acceleration is equivalent to voluntary full prepayment and that, in the latter instance, the method of computing *any* un-

earned portion of the finance charge must be disclosed in the contract.

The Federal Reserve Board Staff's interpretation, issued on July 6, 1977 before the contract in the case at bar was executed, states in pertinent part:

> The fact that the contract is silent concerning rebate upon prepayment after acceleration is not determinative of the issue; the question is whether in fact the creditor does or does not rebate upon prepayment after acceleration in accordance with the rebate method shown on the disclosure statement. In this sense, then, the individual creditor's policy determines whether there is violation of the act and regulation.
> CCH *Consumer Credit Guide* ¶ 31,647 (July 6, 1977)

In the case at bar, the seller does not retain unearned interest upon prepayment in full, according to § 13 on the signature page of the Contract. This practice is not limited to voluntary prepayment under § 13 but also applies to payment of the full balance in the case of default, according to par. 2 of the defendant's affidavit. The affiant specifically states that, upon acceleration in the case of default, "it is the policy and practice of Ford Credit to collect from the debtors that portion of the finance charge which represents the period of time from the date the Contract was executed until the date that the balance owing on the Contract was paid." Paragraph 3 of the affidavit adds that, when the full balance is paid, the unearned portion of the finance charge is rebated to the debtor.

We give great weight to administrative interpretations which have the effect, after due consideration, of modifying previous positions taken by the administrative body. It was the letter of July 6, 1977, quoted above, upon which the Eighth Circuit relied in *Griffith* v. *Superior Ford,* supra p. 7, thereby disagreeing with the Fifth Circuit's decision

which had relied upon an earlier interpretation. *McDaniel* v. *Fulton National Bank of Atlanta,* supra, p. 7. Defendant's affidavit conforms to the Federal Reserve Board Staff letter of July 6, 1977 and is not controverted by any affidavit of the plaintiffs. There is no genuine issue of material fact on this issue and defendant is entitled to summary judgment on pars. 11(c) and (d) of the Complaint.

> (e) By failing to properly disclose Ford as a creditor in this transaction in violation of Regulation Z § 226.6(d).

The reference to Ford is alleged to mean the defendant Ford Motor Credit Co. The complaint here is based upon the following provision in Reg. 226.6(d):

> If there is more than one creditor or lessor in a transaction, each creditor or lessor shall be clearly identified....

The defendant Ford Motor Credit Co. is identified by name as the assignee of the contract on page 1, over the seller's signature. It is also identified by name in the executed Assignment on the reverse side of the contract. Section 15 on the reverse side of the Contract provides further:

> ASSIGNMENT
>
> The original Seller may assign this contract and his assignee shall acquire all of his interest in this contract and the Property and shall be entitled to all the rights and privileges of Seller hereunder. After Buyer receives notice of any such assignment, Buyer shall make all payments hereunder directly to the holder hereof and the original Seller shall not be the agent of the holder for transmission of payments or otherwise. Buyer shall not transfer or otherwise dispose of any interest in this contract or the Property.

No provision of the statute or regulation requires that the terms of an assignment be set forth on the signature page, or that the creditor be identified there. Cf. Reg. 226.8(b)(4), (6) and (7). The only question therefore is whether or not defendant Ford Motor Credit Co. is "clearly identified" in the contract. We find and conclude that it is, since the two clauses referred to above must be read together.

It is difficult to understand what additional identification plaintiffs seek, since the defendant assignee replaces the seller in all respects and becomes *the* creditor at the outset. The better authorities, in our opinion, have approved the identification contained in this contract. *Antonio* v. *Canal Motors, Inc.*, No. 74-3163 (E.D. La. Nov. 17, 1977); *Sharp* v. *Ford Motor Credit Co.*, No. 77-1098 (S.D. Ill. June 8, 1978). The foregoing cases, although apparently not published in any reporter, are not disputed by the plaintiffs, and we take judicial notice of them. These and the other decisions cited herein without reporter references are attached to the defendant's reply memorandum filed July 27, 1978.

Pendent Count II. As mentioned above, Count II is filed under the Illinois Motor Vehicle Retail Installment Sales Act, the pertinent subsections of which are indistinguishable from the Truth in Lending Act and its accompanying regulations. In fact, the State of Illinois has patterned its regulations on Regulation Z for the interpretation of its statute. See *Mirabal* v. *General Motors Acceptance Corp.*, 537 F.2d 871, 883-84 (7th Cir. 1976). If Count I fails to state a claim upon which relief can be granted against Ford Motor Credit Co., Count II must be dismissed for the same reason.

Conclusion. Defendant Ford Motor Credit Co. has filed a counterclaim against the plaintiffs to collect payments allegedly due under the installment contract. This is not a compulsory counterclaim under F.R.C.P. 13(a). Since we

will dismiss the complaint against this defendant, we will dismiss its State court cause of action against the plaintiffs also. *Rivera* v. *McGee,* 77 C 1168 and *Roman* v. *Z-Frank, Inc.,* 76 C 1065 (N.D. Ill. 1978).

Defendant Anderson Brothers Ford has filed a crossclaim against Ford Motor Credit Co. on the theory of an implied contract of indemnity. Defendant Ford Motor Credit Co. has filed a motion to dismiss the crossclaim. This motion has not been briefed, and Anderson Brothers Ford is still a defendant to the complaint. However, in view of our decision dismissing the complaint as to the Ford Motor Credit Co., and in view of the fact that exactly the same violations are charged against Anderson as we have ruled to be ineffective against Ford Motor Credit Co., we see no purpose in maintaining the complaint any longer against Anderson Brothers Ford. If the complaint is dismissed against both defendants, then the crossclaim of Anderson against Ford Motor Credit Co. likewise falls.

The Truth in Lending Act as applied to automobile purchases has spawned more litigation and taken more time of the attorneys and the court over relatively minor controversies than any other truth-in-lending action which we have encountered. Some of the plaintiffs have had the fortitude and financial ability to appeal these cases as far as the Courts of Appeals, with varying results. Most of the cases, however, do not proceed to that stage, and none which have been decided by the Seventh Circuit Court of Appeals involve the details and issues raised herein. The plaintiffs in this case are represented by the Legal Assistance Foundation of Chicago which is supported by public funds. Unless a more representative case is already available for the appeal process in this Circuit, we suggest that the case at bar be used as a test to lay at rest some of the troublesome problems raised by this complaint, concerning which there are a multitude of conflicting court decisions.

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the motion of the defendant Ford Motor Credit Co. to dismiss the complaint pursuant to F.R.C.P. 12(b) is granted, the complaint against defendant Anderson Brothers Ford is dismissed *sua sponte,* the counterclaim of Ford Motor Credit Co. against the plaintiffs is dismissed, without prejudice, for failure of federal jurisdiction, and the crossclaim of Anderson Brothers Ford against the defendant Ford Motor Credit Co. is dismissed as moot. A rule 58 judgment will enter.

ENTER:

/s/ Thomas R. McMillen
JUDGE, U. S. DISTRICT COURT

DATED: Oct. 31, 1978

DECISION OF THE DISTRICT COURT
NOVEMBER 17, 1978

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 78 C 1718

OLGA VALENCIA AND MIGUEL GONZALEZ,

Plaintiffs,

v.

ANDERSON BROTHERS FORD AND FORD MOTOR CREDIT COMPANY,

Defendants.

SUPPLEMENTAL DECISION

We have reviewed the discussion and conclusions under section (a) of our decision dated October 31, 1978 and have decided that they are erroneous. This review was instigated by a letter dated November 6, 1978 from counsel for defendant Ford Motor Credit Co. calling our attention to the recent decision in *Shanks* v. *Greenbriar Dodge, Inc.*, 577 F.2d 296 (5th Cir. 1978) which also adopts the more definitive decision of *Edmondson* v. *Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978).

The *Shanks* decision reversed the unpublished decision which we had cited on page 5 of our decision of October 31, 1978. The *Edmondson* decision relies heavily on *Elzea* v. *National Bank of Georgia*, 570 F.2d 1248 (5th Cir. 1978) which in effect supersedes *Mims* v. *Dixie Finance Corp.*, 426 F. Supp. 627 (N.D. Ga. 1976) on the definition of a security interest. On this point Judge Morgan relied heavily on *Mims* in *Rounds v. Community National Bank in Monmouth*, 454 F.Supp. 883 (S.D. Ill. 1978)

We are satisfied that the *Edmondson* and *Elzea* decisions are correct in holding that the assignment of unearned insurance premiums *is* a security interest under § 1638(a)(10) of the Truth in Lending Act. We are also satisfied that this security interest was not properly disclosed by defendants in accordance with ¶ 226.8(b)(5) of Regulation Z. We will not burden the parties with additional discussion of the reasons for this change other than to refer them to Judge Goldberg's persuasive and perceptive analysis in *Edmondson*.

Although the court in *Edmondson* and *Shanks* does not reach the similar issue regarding insurance proceeds, the rationale of these decisions also applies to the security interest discussed in par. (b) of our decision of October 31, 1978. However, it remains our opinion that this security interest is properly disclosed in Section 12 of the contract, quoted on page 4 of our decision. At least it is disclosed as to property damage or theft insurance, and the parties have not shown the existence of any other insurance covered by the disclosure in Section 12 of the contract.

In view of the foregoing, we have also reconsidered our dismissal of the other pleadings in this case, specifically this defendant's counterclaim, the complaint against Anderson Brothers Ford, and the crossclaim of Anderson against Ford Motor Credit Co. Since the plaintiffs' complaint is still partially viable, the other pleadings will also be reinstated and the Rule 58 judgment vacated. The plaintiffs' motion to dismiss the counterclaim will be reconsidered on its merits, no further briefing required.

The decision and order entered October 31, 1978 is vacated to the extent noted above. Defendants are ordered to file an answer to the complaint, the cross-defendant is ordered to answer the cross-claim, and plaintiffs' motion to dismiss

the counterclaim will be retained under advisement. All pleadings to be filed within ten (10) days hereof. This case will then be called for a report on status on Monday, December 4, 1978 at 11:30 a.m.

ENTER:

/s/ Thomas R. McMillen
Judge, U.S. District Court

DATED: Nov. 17, 1978

DECISION OF THE DISTRICT COURT
JUNE 5, 1979

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 78 C 1718

OLGA VALENCIA AND MIGUEL GONZALEZ,

Plaintiffs,

v.

ANDERSON BROTHERS FORD AND FORD MOTOR CREDIT COMPANY,

Defendants.

DECISION

All parties have filed motions for summary judgment in this case which involves alleged violations of the Federal Truth in Lending Act and the Illinois Motor Vehicle Retail Installment Sales Act. The total amount being financed by the plaintiffs is $1,340.00, and the finance charge is $319.84. This is the fourth contested motion that has been presented in this case and, we trust, the last. We will enter summary judgment in favor of the plaintiffs.

The principal issue to be decided is whether or not the assignment of unearned or returned insurance premiums is a "security interest" which must be disclosed in the purchase contract, pursuant to 15 U.S.C. § 1638(a)(10) and 12 C.F.R. 226.8(b)(5) of Regulation Z.

In our decision of November 17, 1978 that such an assignment must be disclosed, we relied on *Edmondson* v. *Allen-Russell Ford, Inc.*, 577 F.2d 291 (5th Cir. 1978). Certiorari was denied in that case by the United States Supreme Court on May 14, 1979. 47 U.S.L.W. 3744. For the reasons stated in our foregoing decision and in the decision entered December 13, 1978, we believe that *Edmondson* is a correct statement of the law.

Defendants contend that, since plaintiffs made no payments under the contract and paid no insurance premiums but instead rescinded the transaction and consequently caused the insurance policy to be cancelled, the provisions of the above statute and regulation do not take hold. This is a specious argument, because Regulation Z applies to the contract, both at the time it is signed and *in futuro*, requiring disclosures whether or not any payments are made by the purchasers.

Nor does the fact that plaintiffs rescinded the transaction prevent them from collecting damages. Merely a violation of the statute and its regulations is sufficient to create plaintiffs' cause of action under 15 U.S.C. § 1640. See *Mulqueeny* v. *National Commission, etc.*, 549 F.2d 1115, 1120, n.15 (7th Cir. 1977); *White* v. *Arlen Realty & Development Corp.*, 540 F.2d 645 (4th Cir. 1975).

Defendants' alleged reliance on various publications emanating from the Federal Reserve Board is misplaced. In the first place, defendants do not support their alleged reliance with any affidavit or evidence. In fact, the Board's unofficial position at the time plaintiffs' contract was signed appeared to require proper disclosure of defendants' interest. See Public Position Letter No. 377, quoted in *Edmondson*, 577 F.2d at 295, f.n.8. Secondly, Federal Reserve Board letter No. 1263 is not a regulation but is merely an unofficial staff interpretation which, incidentally, was not released until two months after the contract in this case was signed. It does not have the force of a regulation. *Basham* v. *Finance America Corp.*, 583 F.2d 918 (7th Cir. 1978). Finally, since we have already determined that the assignment of insurance premiums, whether paid or unpaid, is a "security interest" within the meaning of the Federal statute and regulation, we need not be concerned with whether or not this definition is consistent with

local state law. The enforcement or effect of a security interest in the local state courts is quite another matter, not involved under the Truth in Lending Act.

Plaintiffs are directed to serve and file an appropriate judgment order in their favor and against defendants within ten (10) days hereof which will dispose of Count I of the complaint. The pendent State law action in Count II will be dismissed without prejudice upon entry of Judgment on Count I.

ENTER:

/s/ Thomas R. McMillen
JUDGE, U. S. DISTRICT COURT

DATED: June 5, 1979

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 78C 1718

OLGA VALENCIA AND MIGUEL GONZALEZ,

Plaintiffs,

vs.

ANDERSON BROS. FORD AND FORD MOTOR CREDIT COMPANY,

Defendants.

JUDGMENT

A decision having been rendered on motions for summary judgment filed by all parties,

IT IS ORDERED AND ADJUDGED:

1. That plaintiff Olga Valencia recover of the defendants Anderson Bros. Ford and Ford Motor Credit Company, jointly and severally, the sum of $639.68, with interest at the rate of 8% per annum accruing from the date of this judgment.

2. That the plaintiff Miguel Gonzalez recover of the defendants Anderson Bros. Ford and Ford Motor Credit Company, jointly and severally, the sum of $639.68, with interest at the rate of 8% per annum accruing from the date of this judgment.

3. The issue of attorney fees and costs is reserved. Plaintiffs shall file a motion for an award of attorney fees and costs within 15 days of the date of this judgment.

4. The counterclaim of the defendant Ford Motor Credit Company is dismissed without prejudice.

ENTER:

/s/ Thomas R. McMillen
Judge, U.S. District Court

DATED: June 15, 1979

UNITED STATES DISTRICT COURT
FOR THE
NORTHERN DISTRICT OF ILLINOIS—
EASTERN DIVISION

Civil Action File No. 78 C 1718

OLGA VALENCIA, *et al*

Plaintiffs

vs.

ANDERSON BROS. FORD, *et al*

Defendants

JUDGMENT

This action came on for (hearing) before the Court, Honorable Thomas R. McMillen, United States District Judge, presiding, and the issues having been duly (heard) and a decision having been duly rendered,

It is Ordered and Adjudged that plaintiff Olga Valencia recover of defendants jointly and severally the sum of $639.68 with interest at the legal rate.

It is ordered and adjudged that plaintiff Miguel Gonzalez recover of defendants jointly and severally, the sum of $639.68 with interest at the legal rate and with costs of the action.

Counterclaim of defendant Ford Motor Credit Co. is dismissed without prejudice.

Dated at Chicago, Illinois, this 15th day of June, 1979.

H. STUART CUNNINGHAM
Clerk of Court

By: /s/ KATHLEEN BRANCH
Deputy Clerk

ORDER OF THE COURT OF APPEALS DENYING PETITION FOR REHEARING

APRIL 22, 1980

UNITED STATES COURT OF APPEALS

For the Seventh Circuit
Chicago, Illinois 60604

April 22, 1980.

Before

Hon. LUTHER M. SWYGERT, Circuit Judge

Hon. ROBERT A. SPRECHER, Circuit Judge

Hon. RICHARD D. CUDAHY, Circuit Judge

No. 79-1950

OLGA VALENCIA AND MIGUEL GONZALEZ,
Plaintiffs-Appellees,

vs.

ANDERSON BROS. FORD AND FORD MOTOR CREDIT COMPANY,
Defendants-Appellants.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

No. 78-C-1718

Thomas R. McMillen, *Judge*

ORDER

On consideration of the petition for rehearing and suggestion for rehearing *in banc* filed in the above-entitled cause by defendants-appellants, no judge in active service has requested a vote thereon, and a majority of the judges on the original panel have voted to deny a rehearing. Accordingly,

IT IS ORDERED that the aforesaid petition for rehearing be, and the same is hereby, DENIED.

OPINION OF THE COURT OF APPEALS FOR THE TENTH CIRCUIT JUNE 24, 1980

UNITED STATES COURT OF APPEALS TENTH CIRCUIT

No. 78-1806

JODY JAMES AND BARBARA JAMES,

Plaintiffs-Appellants,

v

FORD MOTOR CREDIT COMPANY AND DEL NORTE MOTOR COMPANY,

Defendants-Appellees.

Appeal from the United States District Court for the District of Colorado (D. C. No. Civ. 78-F-647)

Richard J. Rubin (with him on the briefs were Paul L. Biderman and Timothy Meehan, attorneys for Northern New Mexico Legal Services, Inc. and Le Roy Cordova) for appellants.

Lawrence W. Treece (with him on the briefs were Holme, Roberts and Owen, and Richard L. Schrepferman and Jeffrey A. Chase) for appellees.

Before SETH, Chief Judge, BREITENSTEIN and DOYLE, Circuit Judges.

BREITENSTEIN, Circuit Judge.

This action, which arose in Colorado, seeks recovery of a statutory civil liability for failure to disclose in an automobile installment purchase contract the right of the seller to a returned and unearned insurance premium on a policy

covering physical damage insurance. The claim is made under the Truth in Lending Act, TILA, 15 U.S.C. § 1601 et seq. as implemented by Federal Reserve Board Regulation Z, 12 C.F.R. § 226. The district court granted a motion to dismiss and the plaintiffs-buyers appeal. We affirm.

The plaintiffs-appellants, Jody and Barbara James, purchased a pick-up truck from defendant-appellee Del Norte Motor Company and executed an installment purchase contract which was assigned to Ford Motor Credit Corporation. The contract shows a cash price of $5395.00, down payments of cash and trade-in totalling $900.50, and a balance due of $4,494.50. To this are added other charges consisting of $359.84 for insurance and $5.50 registration fee. Also added is a finance charge of $1,238.92, at an annual interest rate of 15.40%. The balance due is payable in monthly installments of $169.41.

Paragraph 13 of the signed face page of the contract reads:

> "Security Interest: Seller shall have a security interest under the Uniform Commercial Code in the Property (described above) and to the proceeds thereof to secure the payment in cash of the Total of Payments and all other amounts due or to become due thereunder."

Paragraph 15 on the face page provides that the terms and conditions on the reverse side are incorporated by reference. Paragraph 18 on the reverse side relates to insurance and among other things provides:

> "Buyer hereby assigns to Seller any monies payable under such insurance, by whomever obtained, including returned or unearned premiums, and Seller hereby is authorized on behalf of both Buyer and Seller to receive or collect same, * * *. The proceeds from such insurance, by whomever obtained, shall be applied toward replacement of the indebtedness hereunder in the sole discretion of the Seller."

TILA requires, 15 U.S.C. § 1631(a), that a creditor "clearly and conspicuously, in accordance with the regulations of the Board" disclose the information mandated by the Act. Reg. Z, 12 C.F.R. § 226.8(a) provides that all the disclosures be made on either:

> "(1) The note or other instrument evidencing the obligation on the same side of the page and above the place for the customer's signature; or
>
> (2) One side of a separate statement which identifies the transaction."

Failure to disclose properly the required information subjects the offender to a civil liability of not more than $1,000.00 plus reasonable attorneys' fees. 15 U.S.C. § 1640(a). The purchasers sue for the statutory liability and attorneys' fees. The trial court held that the assignment of the returned and unearned portion of the insurance premium was not a security interest under the Colorado version of the Uniform Commercial Code. See Colo. Rev. Stat. (1973) § 4-9-102.

TILA requires, 15 U.S.C. § 1638(a)(10), the disclosure of "[a] description of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit, and a clear identification of the property to which the security interest relates." The Act does not define "security" or "security interest." Reg. Z provides, 12 C.F.R. § 226.2(gg):

> " 'Security interest' and 'security' mean any interest in property which secures payment or performance of an obligation. The terms include, but are not limited to, security interests under the Uniform Commercial Code, real property mortgages, deeds of trust and [various liens and a lease interest securing performance of an obligation]."

The reference to the Uniform Commercial Code specifically declares that it is not a limitation. Although the interplay of federal and state law presents problems, the right to the TILA civil liability for nondisclosure rests on federal law. TILA is remedial legislation, designed to prevent predatory creditor practices, and must be liberally construed to effectuate the intent of Congress. See Mourning v. Family Publications Service, Inc., 411 U.S. 356, 365, and Littlefield v. Walt Flanagan and Company, 10 Cir., 498 F.2d 1133, 1136.

Three circuits have held that nondisclosure of the seller's rights to unearned and returned premiums violates TILA and subjects the seller to the statutory liability. See Gennuso v. Commercial Bank & Trust Company, 3 Cir., 566 F.2d 437; Edmondson v. Allen-Russell Ford, Inc., 5 Cir., 577 F.2d 291, cert. denied 441 U.S. 951; and Valencia v. Anderson Brothers Ford, 7 Cir., —— F.2d ——. The last of these, Valencia, was decided on March 20, 1980.

On March 31, 1980, the President approved the "Truth in Lending Simplification and Reform Act" as Title VI of the "Monetary Control Act of 1980." P.L. 96-221, 94 Stat. 132. Section 614(a) amends 15 U.S.C. § 1638(a), the disclosure section of TILA. Subsection (a)(9) reads, U.S. Cong. & Adm. News, No. 3, May 1980, 94 Stat. 179:

> "Where the credit is secured, [the creditor shall disclose to the extent applicable] a statement that a security interest has been taken in (A) the property which is purchased as part of the credit transaction, or (B) property not purchased as part of the credit transaction identified by item or type."

S. R. 96-368, U.S. Cong. & Adm. News, supra, p. 850, states the purpose of the 1980 amendments thus:

> "Despite the act's clear successes, however, there is a growing belief among consumers and creditors alike

that the act could be substantially improved. There is considerable evidence, for example, that disclosure forms given consumers are too lengthy and difficult to understand. Creditors, on the other hand, have encountered increasing difficulty in keeping current with a steady stream of administrative interpretations and amendments, as well as highly technical judicial decisions. There is also evidence that many creditors have sincerely tried to comply with the act but, due to its increasing complexity and frequent changes, have nonetheless found themselves in violation and subject to litigation. In addition, this committee and other congressional and government sources have found the level of administrative enforcement by the Federal bank agencies seriously inadequate. In short, the committee believes that the interests of both consumers and creditors would be furthered by simplification and reform of the act."

With particular reference to the amendment of the disclosure requirements of § 1638(a), the Senate Report says, Id. p. 864:

"The security interest disclosure is also simplified to eliminate the technical disclosure of the type of security interest taken. When a security interest is being taken in property purchased as part of the credit transaction, this section requires a statement that a security interest has been or will be taken in the property purchased. When a security interest is being taken in property not purchased as part of the credit transaction, *the Committee intends this provision to require a listing by item or type of the property securing the transaction, but not a listing of related or incidental interests in the property.* For example, a loan secured by an automobile (not being purchased with the proceeds of the loan) would require a statement indicating that the loan is secured by an automobile but would not require a listing of incidental or related rights which the creditor may have such as insurance proceeds or unearned insurance premiums, rights arising

> under, or waived in accord with state law, accessions, accessories or proceeds." (Emphasis supplied)

S. Rep. No. 96-73 says, Id. at 879-880:

> "The subcommittee learned that judging from consumer tests in other areas, the typical disclosure statement utilized today by creditors is not an effective communication device. Most disclosure statements are lengthy, written in legalistic fine print, and have essential truth in lending disclosures scattered among various contactual [sic] terms.
>
> The result is a piece of paper which appears to be 'just another legal document' instead of the simple, concise disclosure form Congress intended."

Ford Motor Credit Co. v. Milhollin, —— U.S. ——, 48 L.W. 4145, decided February 20, 1980, was concerned with the imposition of the statutory liability under TILA for a claimed nondisclosure of an acceleration clause. The Court concluded, 48 L.W. at 4146, that the issue of acceleration disclosure "is not governed by clear expression in the statute or regulation, and * * * it is appropriate to defer to the Federal Reserve Board and staff in determining what resolution of that issue is implied by the truth in lending enactments." The Court examined the Federal Reserve Board staff treatment of acceleration disclosure and denied imposition of the statutory liability.

We are aware of no administrative interpretations pertinent to the particular issue before us. Public Position Letter No. 377, quoted in Edmondson, 577 F.2d 295, n. 8, relates to life insurance, not physical damage insurance. Staff Letter 1263, Consumer Credit Guide (CCH) ¶ 31,736 (November 23, 1977), an unofficial interpretation, leaves to state law the question of whether a security interest has been acquired by the creditor and, if so, whether that interest has been adequately identified.

In Milhollin, supra, 48 L.W. at 4149, the Court said:

> "The concept of 'meaningful disclosure' that animates TILA (citation omitted), cannot be applied in the abstract. *Meaningful* disclosure does not mean *more* disclosure. Rather, it describes a balance between 'competing considerations of complete disclosure . . . and the need to avoid . . . informational overload' (citations omitted) and striking the appropriate balance is an empirical process that entails investigation into consumer psychology and that presupposes broad experience with credit practices." (Emphasis in original).

The Milhollin approach parallels the intent of Congress in enacting the 1980 amendments and the legislative history of those amendments. The effort is to strengthen the impact of TILA by simple, concise disclosures which can be understood by consumers and creditors. The installment contract in issue identifies the security interest taken in the property purchased, the pick-up truck. The insurance charge is specifically noted on the face of the contract and is included in the total amount which must be repaid in monthly installments. The insurance on damage to the vehicle was part of the credit transaction. The right of the seller to the returned premium would seem to be part of the "proceeds" of that transaction. If not such a part, the returned premium is property not purchased. The Senate Report, supra p. 864, says with reference to property not purchased, that the disclosure need not include "a listing of incidental or related rights which the creditor may have such as insurance proceeds or unearned insurance premiums." We are convinced that the Act does not require, and Congress did not intend it to require, an exemplification of that interest on the face of the installment contract. Because of this conclusion, we need not delve into the legal complexities of the Third Circuit decision in Gennuso, 566 F.2d 437; the Fifth

Circuit decision in Edmondson, 577 F.2d 291; and the Seventh Circuit decision in Valencia, —— F.2d ——.

The application of Milhollin and the 1980 actions of Congress present no retroactivity problem. We are concerned only with civil liability for nondisclosure. The buyers have shown no damage. Our decision establishes no new principle of law. Rather, it recognizes the congressional intent. Application to this case furthers the operation of TILA and produces an equitable result. See Chevron Oil Co. v. Huson, 404 U.S. 97, 106-107.

Affirmed.

No. 78-1806—JAMES v. FORD MOTOR CREDIT COMPANY, et al.

DOYLE, Circuit Judge, dissenting.

Because of my belief that the seller's right to unearned and returned premiums is a security interest, and thus the installment purchase contract here violates the Truth in Lending Act, I respectfully dissent.

The question is whether the provision in the contract which provides that the buyer assigns to the seller any monies payable under the insurance (on the car), including returned or unearned premiums, and which authorizes the seller on behalf of both parties to receive or collect same constitutes a violation of the Truth in Lending Act.

Regulation Z, 12 C.F.R. Section 226.2(gg), defines security interest as meaning "any interest in property which secures payment or performance of an obligation. The terms include, but are not limited to, security interests under the Uniform Commercial Code. . . ."

This problem is not a new one. Three circuits have considered this issue and have held that the nondisclosure of

the seller's right to unearned and returned premiums violates the Truth in Lending Act and subjects the seller to the remedy which is being pursued here. The cases are Gennuso v. Commercial Bank & Trust Company, 566 F.2d 437 (3rd Cir. 1977); Edmondson v. Allen-Russell Ford, Inc., 577 F.2d 291 (5th Cir. 1978), *cert. denied* 441 U.S. 951; and Valencia v. Anderson Brothers Ford, —— F.2d —— (7th Cir. March 20, 1980).

The earliest of these decisions is Gennuso v. Commercial Bank & Trust Co., *supra*. Here the plaintiff charged that the Commercial Bank and Trust Company failed to properly identify in the Disclosure Statement and in the Note and Security Agreement a security interest in the proceeds and the unearned premiums in a property insurance policy covering the automobile that he had purchased. It was alleged that such failure violated the Truth in Lending Act and Regulation Z. No mention of the security interest in the insurance policy was made at the top of the note where the collateral was described. There had been some slight mention of the interest in question in the note and security agreement. It was held that the use of general language in this document was sufficient. It was said that the mention of the security interest in after-acquired property satisfied the requirements of the Act. The court held that the conduct of the bank constituted a violation of the Truth in Lending Act and Regulation Z as well.

To the same effect is Edmondson v. Allen-Russell Ford, Inc., *supra*. Here again the court held that the assignment of a returned or unearned premium of an insurance policy was a security interest for purposes of Regulation Z, in accordance with the Truth in Lending Act, and had to be disclosed. The court, through Goldberg, J., had no difficulty concluding that the unearned portion of the premium was a security interest which had to be disclosed. The court relied on Gennuso v. Commercial Bank & Trust Co., *supra*.

Here again the court ruled that it was inadequate to construe the general provision that the " 'Seller shall have a security interest under the Uniform Commercial Code in the Property (described above) and in the proceeds thereof. . . .' " 577 F.2d at 295. The court said that the "lender must disclose the type of security interest held, retained, or acquired and the property of the borrower which serves or will serve as the collateral." 577 F.2d at 295. A sufficient description was determined to be essential.

The third of the recent circuit cases is Valencia v. Anderson Brothers Ford, *supra,* from the Seventh Circuit. The court said:

> We therefore affirm the district court's ruling that an assignment of unearned or returned insurance premiums in a consumer credit installment contract is a security interest for purposes of disclosure under the TILA. This result is consistent with the liberal interpretation to be given the Act, the majority of federal court decisions addressing the issue, and a Federal Reserve Board staff interpretation of a closely analogous issue. In view of the interest in uniformity in TILA disclosures and in the absence of any persuasive argument to the contrary, we decline to break with the Third and Fifth Circuits on this issue.

Slip op. at p. 14.

The majority was influenced by the fact that on March 31, 1980, the President approved the "Truth in Lending Simplification and Reform Act," which amended 15 U.S.C. Section 1638(a), the disclosure section of the Truth in Lending Act. As amended, it was pointed out by the majority that this section permits disclosure of the principal property which provides the security for the loan. It does not require, so the Report says, a listing of related or incidental interests in the property, and it gives as an example a loan secured by an automobile which is not being purchased with the proceeds of the loan, but which would require a state-

ment indicating that the loan is secured by an automobile. It would not require a listing of incidental or related rights which the creditor may have such as insurance proceeds or unearned insurance premiums.

The majority also calls attention to the recent opinion of the Supreme Court in Ford Motor Credit Co. v. Milhollin, ____ U.S. ____, 48 L.W. 4145, decided February 20, 1980, which adopted the approach that security documents have, in the past, carried too much excess luggage and that they should disclose with simplicity and should limit themselves to the disclosure of the matters having to do with the security itself. This may well be the present tendency, but at the time of the occurrence in question the approach which is shown by the Third, Fifth and Seventh Circuits obtained.

In summary, the automobile insurance policy and, of course, the premium which is paid to obtain the coverage, are part and parcel of the entire automobile financing business. It makes the loan more secure.[1] Thus the unearned premium which would ordinarily go to the insured and which is being held back by the lender is information of genuine interest to the purchaser-insured, and it is not possible to cause it to be unimportant.

The new approach might render the procedure less complicated. Nevertheless, I submit that we are not justified in adopting this concept so as to apply it to the present set of facts and to do so only on the basis of legislative history which attended the enactment of the amendments. Even if the legislative history would call for a different result, it should not be applied here in a retroactive way.

For the reasons stated, I disagree with the majority opinion.

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[1] If, for example, the automobile were to be stolen or totaled out in an accident, there would be no security in the absence of insurance.

ACCOUNT NO. _____

ILLINOIS AUTOMOBILE RETAIL INSTALLMENT CONTRACT Dr

Buyer (and Co-Buyer) - Name and Address (Include - County and Zip Code)

OLGA A. VALENCIA + MIGUEL GONZALES
2431 S. RIDGEWAY
CHGO, IL 60623

Seller - Name and Address

Anderson Bros Ford
6539 Ogden Ave.
Berwyn, IL 60402

Buyer (which means the undersigned Buyers and Co-buyers, jointly and severally) having been quoted both a deferred payment price and a lesser cash price hereby purchases from Seller on a deferred payment price basis, upon the terms and conditions set forth on the face and reverse sides hereof, the following property (hereinafter called the "Property") delivery and acceptance of which in good order hereby are acknowledged by Buyer.

New or Used	Year and Make	Series	Body Style	No. Cyl.	If Truck Ton Capacity	Manufacturer's Serial Number	Use For Which Purchased
U	74 FORD	PINTO	2dr.	4		4X10Y785345	☒ Personal ☐ Agriculture ☐ Business

INCLUDING: ☒ Radio ☐ Air Conditioner ☒ Automatic Transmission ☐ Power Steering ☐ Power Brakes ☐ Power Seats ☐ Power Windows ☒ Service Contract

DESCRIPTION OF TRADE IN

_____ (Year and Make)

$ _____ (Gross Allowance)

$ — (Amount Owing)

OPTIONAL INSURANCE

Buyer authorizes Seller to obtain the following insurance coverages:

(a) **Physical Damage Insurance:** Coverages checked below for a term of _____ months (or for such shorter term as the insurer to whom Seller shall apply therefor will provide for the amount included herein) from the date hereof, payable to Buyer or Seller as interests may appear:

☐ Comprehensive ☐ Fire-Theft & Combined Additional Coverage

☐ $_____ Deductible Collision ☐ Towing & Labor Costs ($25.00 Limit)

$ _____ (a)

(b) **Credit Life Insurance** on the life of _____ (Insured Person) for the term of this Contract.

☐ Provided under Ford Life Insurance Company's Group Policy No. 2200 in accordance with the "Credit Life Insurance Eligibility" section below.

☐ Provided by _____ in accordance with the separate Application, Notice, Certificate or Policy delivered to Buyer this date.

$ — (b)

(c) **Credit Accident and Health or Disability Insurance** provided by

DETAILS OF TRANSACTION

(1) Cash Price		$3412.00 (1)
Cash Down Payment	$1,000.00	
Trade In (See Opposite)	$ —	
(2) Total Down Payment		$1,000.00 (2)
(3) Unpaid Balance of Cash Price (Difference between Items 1 & 2)		$2412.00 (3)
(4) Other Charges	Service Contract	$ —
Optional Insurance (See Opposite)	$	
Official Fees	$	
Taxes (Not included in Cash Price)	$	
License, Title & Registration Fees	$	
Total Other Charges		$ — (4)
(5) Unpaid Balance - Amount Financed		$2412.00 (5)
(6) FINANCE CHARGE		$ 319.20 (6)
(7) ANNUAL PERCENTAGE RATE	21.44 %	(7)
(8) Total of Payments (Sum of Items 5 & 6)		$2731.20 (8)

(9) Payment Schedule: Buyer hereby agrees to pay to Seller the Total of Payments (Item 8 above) in 23 monthly instalments of $ 9.12 each and one final instalment of $ 9.24 on the like day of each month commencing Nov 2 19 77, or, if no date is specified, one month after the date of this contract.

☐ $_____ Deductible ☐ Collision ☐ Towing & Labor Costs ($25.00 Limit) /

(b) Credit Life Insurance on the life of _____ for the term of this Contract. (Insured Person)

☐ Provided under Ford Life Insurance Company's Group Policy No. 2200 in accordance with the "Credit Life Insurance Eligibility" section below.

☐ Provided by _____ in accordance with the separate Application, Notice, Certificate or Policy delivered to Buyer this date. $_____ (b)

(c) Credit Accident and Health or Disability Insurance provided by _____ for the term of this Contract in accordance with the separate Application, Notice, Certificate or Policy delivered to Buyer this date..... $_____ (c)

(d) Other Optional Insurance _____ (Itemize) $_____ (d)

Total Cost of Optional Insurance..... $_____

NOTICE TO BUYER: (1) You are not required to obtain the Credit Life and/or Credit Accident and Health or Disability Insurance for which a charge is indicated above and such is not a factor in the Seller's approval of this credit. Such insurance may be cancelled from its inception within 15 days from the date hereof by written request from each Buyer and any Guarantor. Upon cancellation, the entire charge therefor shall be refunded or credited to Buyer. (2) You have the right to choose the person through whom the Physical Damage Insurance required under this contract is to be obtained. **ACKNOWLEDGING** the foregoing, **BUYER** requests and authorizes **SELLER** to obtain each insurance coverage for which an amount is included above.

Buyer _____ Date _____

_____ Date _____

(Cost Of Insurance To Be Included Only If Signed By Each Insured Buyer And Dated).

LIABILITY INSURANCE COVERAGE FOR BODILY INJURY AND PROPERTY DAMAGE CAUSED TO OTHERS IS NOT INCLUDED.

CREDIT LIFE INSURANCE ELIGIBILITY

Credit life insurance under Ford Life Insurance Company's Group Policy No. 2200 is available only on the life of one natural person who is obligated to make payments under this retail instalment instrument and who is under the age of 66 on the date hereof. Benefits will be limited to a refund of premiums if there is no person eligible for such insurance, or if death results from suicide within one year from the date hereof or from certain pre-existing diseases or conditions within ninety days from the date hereof. For details see Notice of Proposed Group Credit Life Insurance on reverse side of Buyer's Copy.

The foregoing contract hereby is accepted by the Seller and assigned to *Ford Motor Credit Company* in accordance with the terms of the Assignment set forth on the reverse side hereof.

Seller _____

By _____ Title _____

Total Other Charges	$	(4)
(5) Unpaid Balance – Amount Financed	$ 1340.62	(5)
(6) FINANCE CHARGE	$ 319.22	(6)
(7) ANNUAL PERCENTAGE RATE	21¼ %	(7)
(8) Total of Payments (Sum of Items 5 & 6)	1659.84	(8)

(9) Payment Schedule: Buyer hereby agrees to pay to Seller the Total of Payments (Item 8 above) in 23 monthly instalments of $ 69.12 each and one final instalment of $ 69.12 on the like day of each month commencing Nov 2 19 77, or, if no date is specified, one month after the date of this contract.

(10) Deferred Payment Price (Sum of Items 1, 4 & 6) $ 2659.84 (10)

(11) Delinquency Charges: Buyer hereby agrees to pay a delinquency charge on each instalment in default for more than 10 days in the amount of 5% thereof or $5.00, whichever is less, plus such expenses incurred by Seller in effecting collection hereunder as may be allowed by law.

(12) Security Interest: Seller shall have a security interest under the Uniform Commercial Code in the Property (described above) and in the proceeds thereof to secure the payment in cash of the Total of Payments and all other amounts due or to become due hereunder.

(13) Prepayment Rebate: Buyer may prepay his obligations under this contract in full at any time prior to maturity of the final instalment hereunder, and, if he does so, shall receive a rebate of the unearned portion of the Finance Charge computed under the sum of the digits method after first deducting an acquisition fee of $25.00. No rebate will be made if the amount thereof is less than $1.00.

(14) Additional Terms and Conditions: The additional terms and conditions set forth on the reverse side hereof are a part of this contract and are incorporated herein by reference.

NOTICE TO THE BUYER

1. **Do not sign this agreement before you read it or if it contains any blank spaces.**
2. **You are entitled to an exact copy of the agreement you sign.**
3. **Under the law you have the right, among others, to pay in advance the full amount due and to obtain under certain conditions a partial refund of the finance charge.**

Buyer acknowledges receipt of a true and completely filled in copy of this contract at time of signing.

RETAIL INSTALLMENT CONTRACT

Buyer Signs _____

Co-Buyer Signs Miguel Gonzalez

Guarantor Signs _____

I hereby guarantee the collection of the above described amount upon failure of the seller named herein to collect said amount from the buyer named herein.

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

ADDITIONAL TERMS AND CONDITIONS

15. ASSIGNMENT

The original Seller may assign this contract and his assignee shall acquire all of his interest in this contract and the Property and shall be entitled to all the rights and privileges of Seller hereunder. After Buyer receives notice of any such assignment, Buyer shall make all payments hereunder directly to the holder hereof and the original Seller shall not be the agent of the holder for transmission of payments or otherwise. Buyer shall not transfer or otherwise dispose of any interest in this contract or the Property.

16. USE OF PROPERTY – WARRANTIES

Buyer shall keep the Property free from all encumbrances, and any amount that may be paid by Seller in release or discharge thereof shall be paid by Buyer to Seller forthwith upon demand with interest at the highest lawful contract rate. Buyer shall not use the Property illegally, improperly or for hire (unless stated herein) and shall not remove the Property from the county of his residence without the written permission of Seller. **No representation, promise or warranty, express or implied, has been made with respect to the merchantability, suitability or fitness for purpose of the Property or otherwise unless the same is endorsed hereon in writing or is contained in a separate written instrument signed by the original Seller.**

RISK OF LOSS – INSURANCE

The Property shall be at Buyer's risk. Buyer shall obtain and maintain at his own expense for so long as any amount remains unpaid hereunder insurance protecting the interests of Buyer and Seller against loss, damage or destruction of or to the Property in such forms and amounts as Seller may require. The inclusion of a charge for insurance herein shall not relieve Buyer of such obligation but only authorizes Seller to attempt to obtain the requested coverages on Buyer's behalf through an authorized agent; provided, if Seller is unable to obtain the requested coverages for the term indicated for the amount included herein, Seller may (i) obtain such coverages for such term, if any, as the insurance carrier to whom Seller shall apply therefor will provide for such amount, or (ii) credit such amount to the final maturing instalments hereunder in inverse order of maturity or as otherwise required by law.

If Buyer fails to obtain or maintain such insurance, or fails to furnish satisfactory evidence thereof upon request, Seller may, but shall not be required to, and without prejudice to his rights hereunder if he does not, obtain such insurance protecting either the interests of Buyer and Seller or the interests of Seller only. In such event, Buyer agrees to reimburse Seller for the cost thereof forthwith upon demand together with interest thereon at the highest lawful contract rate.

Buyer hereby assigns to Seller any monies payable under such insurance, by whomever obtained, including returned or unearned premiums, and Seller hereby is authorized on behalf of both Buyer and Seller to receive or collect same, to endorse checks or drafts in payment thereof, to cancel such insurance or to release or settle any claim with respect thereto. The proceeds from such insurance, by whomever obtained, shall be applied toward replacement of the Property or payment of the indebtedness hereunder in the sole discretion of Seller.

18. DEFAULT

Time is of the essence of this contract. In the event Buyer defaults in any payment, or fails to obtain or maintain the insurance required hereunder, or fails to comply with any other provision hereof, or a proceeding in bankruptcy, receivership or insolvency shall be instituted by or against Buyer or his property, or Seller deems the Property in danger of misuse or confiscation, or Seller otherwise reasonably deems the indebtedness or the Property insecure, Seller shall have the right to declare all amounts due or to become due hereunder to be immediately due and payable and Seller shall have all the rights and remedies of a Secured Party under the Uniform Commercial Code, including the right to repossess the Property wherever the same may be found with free right of entry, and to recondition and sell the same at public or private sale. Upon request, Buyer shall deliver the Property to Seller at a place designated by Seller. Seller shall have the right to retain all payments made prior to repossession and Buyer shall remain liable for any deficiency. Any personalty in or attached to the Property when repossessed may be held by Seller without liability and Buyer shall be deemed to have waived any claim thereto unless written demand by certified mail is made upon Seller within 24 hours after repossession. Buyer agrees to pay reasonable attorneys' fees (15% if permitted by law) and other expenses incurred by Seller in effecting collection, repossession or resale hereunder. Seller's remedies hereunder are in addition to any given by law and may be enforced successively or concurrently. Waiver by Seller of any default shall not be deemed a waiver of any other default.

19. GENERAL

No transfer, renewal, extension or assignment of this contract or any interest hereunder, and no loss, damage or destruction of or to the Property, shall release Buyer from his obligations hereunder. This contract constitutes the entire agreement between the parties and no modification hereof shall be valid in any event, and Buyer expressly waives the right to rely thereon, unless made in writing signed by Seller. Any provision of this contract prohibited by applicable law shall be ineffective to the extent of such prohibition without invalidating any other provision of this contract. This contract shall be governed by the laws of the state in which the original Seller is located as shown on the face of this contract.

GUARANTY

For Value Received, each of the undersigned guarantors, jointly and severally, guaranties the prompt and unconditional payment, performance and discharge of all Buyer's obligations under the within contract and covenants that in the event of default in any of said obligations thereunder, to pay upon demand the full amount remaining unpaid thereunder together with a reasonable attorney's fee (15% of the amount then due, or if prohibited, the amount permitted by law) if placed with an attorney for collection. The liability of undersigned shall not be affected by any extension, renewal or other change in the time of payment of the said contract, or any change in the manner, place or terms of payment thereof, or the release, settlement or compromise of or with any party liable for the payment thereof, or the release or non-perfection of any security thereunder. The holder of the within contract shall not be bound to exhaust its recourse against Buyer or any other person or any security the holder may at any time have before being entitled to payment from the undersigned hereunder. Each of the undersigned guarantors hereby waives notice of the acceptance of this guaranty, and of presentment, demand and protest and notices of non-payment and dishonor, and any other demands and notices required by law.

Guarantor _____ Address _____

Guarantor _____ Address _____

tain at his own expense for so long as any amount remains unpaid hereunder insurance protecting the interests of Buyer and Seller against loss, damage or destruction of or to the Property in such forms and amounts as Seller may require. The inclusion of a charge for insurance herein shall not relieve Buyer of such obligation but only authorizes Seller to attempt to obtain the requested coverages on Buyer's behalf through an authorized agent; provided, if Seller is unable to obtain the requested coverages for the term indicated for the amount included herein, Seller may (i) obtain such coverages for such term, if any, as the insurance carrier to whom Seller shall apply therefor will provide for such amount, or (ii) credit such amount to the final maturing instalments hereunder in inverse order of maturity or as otherwise required by law.

If Buyer fails to obtain or maintain such insurance, or fails to furnish satisfactory evidence thereof upon request, Seller may, but shall not be required to, and without prejudice to his rights hereunder if he does not, obtain such insurance protecting either the interests of Buyer and Seller or the interests of Seller only. In such event, Buyer agrees to reimburse Seller for the cost thereof forthwith upon demand together with interest thereon at the highest lawful contract rate.

unless written demand by certified mail is made upon Seller within 24 hours after repossession. Buyer agrees to pay reasonable attorneys' fees (15% if permitted by law) and other expenses incurred by Seller in effecting collection, repossession or resale hereunder. Seller's remedies hereunder are in addition to any given by law and may be enforced successively or concurrently. Waiver by Seller of any default shall not be deemed a waiver of any other default.

19. GENERAL

No transfer, renewal, extension or assignment of this contract or any interest hereunder, and no loss, damage or destruction of or to the Property, shall release Buyer from his obligations hereunder. This contract constitutes the entire agreement between the parties and no modification hereof shall be valid in any event, and Buyer expressly waives the right to rely thereon, unless made in writing signed by Seller. Any provision of this contract prohibited by applicable law shall be ineffective to the extent of such prohibition without invalidating any other provision of this contract. This contract shall be governed by the laws of the state in which the original Seller is located as shown on the face of this contract.

GUARANTY

For Value Received, each of the undersigned guarantors, jointly and severally, guaranties the prompt and unconditional payment, performance and discharge of all Buyer's obligations under the within contract and covenants that in the event of default in any of said obligations thereunder, to pay upon demand the full amount remaining unpaid thereunder togetner with a reasonable attorney's fee (15% of the amount then due, or if prohibited, the amount permitted by law) if placed with an attorney for collection. The liability of undersigned shall not be affected by any extension, renewal or other change in the time of payment of the said contract, or any change in the manner, place or terms of payment thereof, or the release, settlement or compromise of or with any party liable for the payment thereof, or the release or non-perfection of any security thereunder. The holder of the within contract shall not be bound to exhaust its recourse against Buyer or any other person or any security the holder may at any time have before being entitled to payment from the undersigned hereunder. Each of the undersigned guarantors hereby waives notice of the acceptance of this guaranty, and of presentment, demand and protest and notices of non-payment and dishonor, and any other demands and notices required by law.

Guarantor_____ Address_____

Guarantor_____ Address_____

FORD LIFE INSURANCE COMPANY
NOTICE OF PROPOSED GROUP CREDIT LIFE INSURANCE

Notice hereby is given that if a charge for group credit life insurance to be provided by Ford Life Insurance Company, Dearborn, Michigan, under its Group Policy No. 2200 is separately stated as a part of the balance payable under the annexed retail instalment instrument, and if such instrument is assigned or otherwise transferred to Ford Motor Credit Company, the group policyholder, and if the person to be insured is eligible for such insurance as hereinafter provided, life insurance protection under the said Group Policy will be provided upon the life of such person with respect to such instrument. Any natural person is eligible for such insurance if he is primarily or secondarily obligated to make the payments provided in such instrument and has not attained his 66th birthday on or before the effective date of such instrument. The Insured Person will be the person named as such in such instrument if such person is eligible for insurance hereunder. In the event no person is named as the Insured Person, or if the person so named is not eligible for such insurance, then the Insured Person will be: (a) if the Buyer named in such instrument is one or more natural persons, that natural person whose signature as "Buyer" appears first; (b) if the Buyer named therein is a partnership, that natural person, being a partner, whose signature on behalf of the partnership appears first; or (c) if any Buyer named therein is a corporation, that natural person who is personally obligated on the instrument and whose signature as "Buyer" or "Co-Buyer" appears first; provided that in the event there is no natural person obligated under such instrument under the age of 66 as of the effective date thereof, all provisions with respect to such credit life insurance will be void and of no effect. Such insurance will become effective from the date the obligation of the Buyer named in such instrument is incurred and will, in the absence of default in any payment coming due thereunder, remain in force, subject to the terms of the Group Policy, until discharge of all obligations thereunder. Any amount becoming payable at the death of the Insured Person will be applied to reduce or extinguish Buyer's obligation thereunder. The amount of insurance will be the amount owing from time to time under such instrument but not to exceed $10,000 less the amount of existing insurance on the date of such instrument with respect to any other obligation for which the Buyer is insured under the said Group Policy; provided that the amount payable under the said Group Policy will be limited to a credit or refund of the amount included as the premium or cost of such insurance in such instrument in the event that death of the Insured Person results from (a) suicide, while sane or insane, within one year from the effective date of the insurance, or (b) a disease, injury or health condition for which the Insured Person was hospitalized or received medical treatment within the thirty days immediately preceding the effective date of the insurance, if death occurs within the ninety days immediately following such date. If the insurance becomes effective, a certificate of insurance describing the coverage afforded in greater detail will be furnished to the Buyer within thirty days. If the insurance is declined by the insurer or otherwise does not become effective or if a charge for an amount of insurance in excess of the foregoing limit is made, notice thereof will be sent to the Buyer and the appropriate portion of the charge for such insurance together with the finance charge applicable thereto promptly will be credited or refunded to the Buyer. In the event such insurance terminates during the lifetime of the Insured Person, the portion of the insurance charge applicable to the period subsequent to the date of termination will be refunded or credited to the Buyer. No refund or credit of insurance charge will be made if the amount thereof is less than $1.00. The insurance charge refund formula is on file with the state official having supervision of the proposed insurance and a copy thereof is on file with the group policyholder.
FL13025

THE ABOVE NOTICE APPLIES ONLY IF A CHARGE FOR CREDIT LIFE INSURANCE UNDER FORD LIFE INSURANCE COMPANY'S GROUP POLICY NO. 2200 HAS BEEN STATED IN THE ANNEXED INSTRUMENT. IF A CHARGE FOR OTHER CREDIT LIFE INSURANCE OR OTHER INSURANCE HAS BEEN INCLUDED THEREIN, BUYER WILL BE FURNISHED WITH SUCH APPLICATION, NOTICE, CERTIFICATE OR POLICY WITH RESPECT THERETO AS IS REQUIRED BY LAW.

FMCC 11712 May 76

Deft Dep. Ex. No. 10 Id.
Date: 2/2/79
Reporter: D.C.